In the

# Supreme Court of the United States

October Term, 1977

No. 77-952

GROUP LIFE AND HEALTH INSURANCE COMPANY a/k/a BLUE SHIELD and/or BLUE CROSS-BLUE SHIELD OF TEXAS, WALGREEN TEXAS COMPANY, THE SOMMERS DRUG STORES COMPANY, RIEGER/MEDI-SAVE PHARMACIES, INC. d/b/a GIBSONS PHARMACY,

*Petitioners,*

*v.*

ROYAL DRUG COMPANY, INC. d/b/a ROYAL PHARMACY OF CASTLE HILLS and DISCO PRESCRIPTION PHARMACY, BLAUSER'S PHARMACY, INC., PARKERS PHARMACY, INC., CRAIG BELL d/b/a BELL PHARMACY, GEORGE STONE d/b/a OLMOS PHARMACY, HIGHLAND HILLS PHARMACY, INC., ECONODOSE SYSTEMS, INC. d/b/a MEDICAL CENTER PHARMACY, GUSTAVE HNCIR d/b/a TURNERS PHARMACISTS, CARLOS DIAZ d/b/a VALLEY VIEW PHARMACY, ALFRED SANGALLI d/b/a STAR DRUG STORE, BLANCO PHARMACY, INC., BLANCO SOUTHSIDE PHARMACY, INC., DAN PARADA d/b/a DAN'S PHARMACY, RODOLFO L. DAVILA, INC. d/b/a DAVILA PHARMACY, DELLMAR PHARMACY #4, RONG, INC. d/b/a ECONOMY PHARMACY #1, ZARZAMORA, PHARMACY, INC., and WHITE CROSS PROFESSIONAL PHARMACY, INC. d/b/a WHITE CROSS #1 and d/b/a WHITE CROSS #4,

*Respondents.*

**On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit**

## BRIEF FOR RESPONDENTS

TINSMAN & HOUSER, INC.,
1900 Nat'l Bank of
Commerce Bldg.,
San Antonio, Texas 78205,
(512) 225-3121,
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d/b/a BELL PHARMACY, GEORGE STONE d/b/a OLMOS PHARMACY, HIGHLAND HILLS PHARMACY, INC., ECONODOSE SYSTEMS, INC. d/b/a MEDICAL CENTER PHARMACY, GUSTAVE HNCIR d/b/a TURNERS PHARMACISTS, CARLOS DIAZ d/b/a VALLEY VIEW PHARMACY, ALFRED SANGALLI d/b/a STAR DRUG STORE, BLANCO PHARMACY, INC., BLANCO SOUTHSIDE PHARMACY, INC., DAN PARADA d/b/a DAN'S PHARMACY, RODOLFO L. DAVILA, INC. d/b/a DAVILA PHARMACY, DELLMAR PHARMACY #4, RONG, INC. d/b/a ECONOMY PHARMACY #1, ZARZAMORA PHARMACY, INC., and WHITE CROSS PROFESSIONAL PHARMACY, INC. d/b/a WHITE CROSS #1 and d/b/a WHITE CROSS #4, request that the Court affirm the judgment of the United States Court of Appeals for the Fifth Circuit in this case.

## OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit is reported at 566 F. 2d 1375. The opinion of the United States District Court for the Western District of Texas is reported at 415 F. Supp. 343. The Court of Appeals and District Court opinions are reproduced at pages 117a-138a and 100a-115a of the Appendix ("App.')

## QUESTIONS PRESENTED

Petitioners have posed the following as the question for review:

> [W]hether the "business of insurance," within the meaning of the antitrust exemption afforded by the McCarran Act, includes a contract between an insurer and a health care provider to furnish benefits owed to policyholders under the insurer's health care policies. (Brief for Petitioners at 2).



Respondents respectfully submit that the global question articulated by Petitioners is not the question to be decided by the Court. Nevertheless, it is instructive to critically analyze Petitioners' question against the backdrop of Petitioners' actu[illegible]nduct and activities. Such analysis underscores the mockery Petitioners desire to make of the McCarran-Ferguson Act and the threat their activities pose to competition and to continued survival of small independent business in this country.

Respondents have not contended, and the United States Court of Appeals for the Fifth Circuit (the Fifth Circuit) did not hold that all contracts between insurers and health care providers *to furnish benefits owed to policyholders* are outside the "business of insurance." The real issue is whether there is a blanket McCarran-Ferguson Act exemption for contracts between insurers and providers of benefits, which *ipso facto* exempts from federal antitrust scrutiny any and all activities the ingenuity of insurers can implement through such contracts. Congress never intended to blindfold the courts in the manner desired by Petitioners. The individual activities embodied within or implemented through the contract with providers must be scrutinized to determine whether they, regardless of the camouflage or window dressing, actually are part of the "business of insurance." In this regard, there are actually four questions to be determined by the Court. They are as follows:

1. Whether Petitioners' activities in combining and conspiring to fix the retail sales prices of pharmaceuticals, in conspiring to effect a boycott of pharmacy owners who refuse to fix prices, and in conspiring to foreclose pharmacy owners who refuse to fix prices from a substantial portion of the market constitute the "business of insurance."

2. Whether Texas' entire want of regulation in the area of Petitioners' anticompetitive activities renders the Sherman Act applicable to such activities.
3. Whether the existence of boycott, coercion, and intimidation eliminates the immunizing effects of the McCarran-Ferguson Act in this case.
4. Whether retail pharmacy chains can avoid the Sherman Act's proscriptions by combining with an insurance company and utilizing it as an intermediary to eliminate price and other forms of competition in the retail pharmaceutical industry.

## STATEMENT OF THS CASE

Respondents are eighteen (18) independent retail pharmacy owners doing business in Bexar County, Texas. Petitioners include an insurance company, GROUP LIFE AND HEALTH INSURANCE COMPANY (Blue Shield), which sells life, health and accident insurance policies *for profit* (App. 300a); and three retail pharmacy chains, WALGREEN TEXAS COMPANY (Walgreens), THE SOMMERS DRUG STORES COMPANY (Sommers), and RIEGER/MEDI-SAVE PHARMACIES, INC. (Rieger), which operate retail pharmacies in Bexar Ccunty, Texas.

Respondents brought this action seeking redress for Petitioners' activities in violation of section 1 of the Sherman Act, 15 U.S.C. §1 (1970). In reliance on the McCarran-Ferguson Act, 15 U.S.C. §1011 *et. seq.* (1970), the District Court granted a summary judgment for Petitioners. The United States Court of Appeals for the Fifth Circuit reversed, holding that the activities challenged by Respondents are not a part of the business of insurance.

### A. Petitioners' Anticompetitive Activities

In 1969, Blue Shield first offered prescription drug insurance coverage to certain groups in Texas as a supplemental



policy to its group medical-surgical insurance policies. (Depo. of Judith J. Johnson ("Johnson Depo.") at 9-10, App. 143a)[1]. A copy of this supplemental policy (the Prescription Drug Insurance Policy) is set forth at pages 303a-310a of the Appendix. (McDonald Depo. Exhibit 37). Prior to 1969, Blue Shield had not offered similar coverage. (Johnson Depo. at 12, App. 145a). With the minor changes in wording as reflected in pages 311a-318a of the Appendix (McDonald Depo. Exhibit 39), Blue Shield has continued to market the Prescrpition Drug Insurance Policy in Texas. In recent years, the number of pharmaceutical sales covered by this policy have risen dramatically. Between early 1972 and October, 1975, alone, there was a 3,100% increase in the number of pharmaceutical claims processed by Blue Shield under the policy. In October, 1975, Blue Shield was handling these claims at the rate of approximately 31,000 claims per month as compared with only 1,000 claims per month in early 1972. (Deposition of Lee Helis (Helis Depo.) at 9-10, App. 280a-281a).[2]

Contemporaneous to its making this insurance available, Blue Shield contacted retail pharmacies concerning their entering into a Participating Drug Pharmacy Agreement (The Pharmacy Agreement). A copy of The Pharmacy Agreement is set forth at pages 200a-204a of the Appendix.

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[1] Ms. Johnson is Assistant Vice President of Medical Administration for Group Hospital Service, Inc. and Group Life and Health Insurance Company (Blue Cross-Blue Shield of Texas). She is responsible for the on-going administration of the Blue Shield Prescription Drug Program with pharmacies as it relates to enrolling participating pharmacies and has been employed by Blue Cross-Blue Shield of Texas for twenty-six years. (Johnson Depo. at 4-6, App. 141a-143a).

[2] Mr. Helis is manager of regular claims for Blue Cross-Blue Shield of Texas.

(Johnson Depo. Exhibit 19). It has not changed since its inception in 1969.[3] (Johnson Depo. at 13, App. 145a).

Petitioners innocuously describe The Pharmacy Agreement as follows:

> [T]he mechanism through which prescription drug benefits are provided to insureds in accordance with Blue Shield's obligations under the policy. (Brief for Petitioners at 4).

As is discussed extensively *infra*, it is neither the purpose nor the effect of The Pharmacy Agreement to serve as a "mechanism through which prescription drug benefits are provided to insureds." Rather, as is evident from its provisions, The Pharmacy Agreement is purely and simply a price fixing agreement. Pursuant to paragraph 4 of the instrument, the participating pharmacy agrees to set its retail sales prices for all sales of prescription pharmaceuticals to Blue Shield's subscribers at an amount equal to the pharmacy's acquisition cost for the particular drug plus a "professional dispensing fee of $2.00". (Johnson Depo. Exhibit 19, App. 201a-202a). That the Agreement is merely a price fixing agreement is further reinforced by Blue Shield's own construction thereof. On Page II-2 of Blue Shield's Pharmacy Manual, it defines a "Participating Provider" (a pharmacy that has signed The Pharmacy Agreement) as follows:

> A Provider who has entered into a Participating Contract with Blue Shield of Texas to provide a Covered Drug at a cost to a subscriber not to exceed the Copayment Amount of $2.00 and *a total payment from Blue Shield and the subscriber not to exceed the cost of the Covered Drug plus a dispensing fee (of $2.00).* (Johnson Depo. Exhibit 2, App. 169a) (emphasis added).[4]

[3] The Pharmacy Agreement mentioned by Petitioners on page 4 of their brief, which appears at App. 59a-61a, differs from the Pharmacy Agreement actually utilized with Texas pharmacies. Compare App. 59a-61a with App. 200a-204a. Unless otherwise indicatd, Respondents' references to The Pharmacy Agreement refer to the Agreement as reproduced at App. 200a-204a.



Significantly, in describing a pharmacy that has signed The Pharmacy Agreement, Blue Shield finds it salient to describe only one characteristic of the Agreement — the pharmacy's obligation to charge its costs, as defined, plus a fixed, uniform dispensing fee. Each of the "Participating Pharmacies" knows that those of his competitors who sign the Pharmacy Agreement will be charging the same prices (Johnson Depo. Exhibit 2 at II-7, App. 175a) and that Blue Shield will not deal with a pharmacist who has refused to agree on prices. (Johnson Depo. Exhibit 2 at II-7, App. 176a). The Prescription Drug Insurance Policy does not require price fixing, but only that participating pharmacies agree to furnish covered drugs.

The pharmacies that sign The Pharmacy Agreement can charge no more for their prescription drugs than the amount specified therein, regardless of the magnitude of a particular drug's acquisition cost. (Johnson Depo. at 40, 53-55, App. 153a-155a). Thus, the participating pharmacy is limited to a $2.00 markup (the "professional dispensing fee") whether its actual acquisition cost for a particular drug is $8.00 or $80.00. With respect to specialized and highly expensive pharmaceuticals, The Pharmacy Agreement can result in the pharmacy owner's being allowed a mark-up that will not even cover the interest on his investment in inventory .

[4] Page II-6 of Blue Shield's Pharmacy Manual provides that the "dispensing fee" in Texas shall be $2.00. (Johnson Depo. Exhibit 2, App. 175a).

The retail sales price, as fixed in The Pharmacy Agreement between Blue Shield and the Petitioner pharmacy chains, has been set at a level below that at which small independent pharmacies can profitably conduct business. Only large, high volume chains that sell many items in addition to pharmaceuticals can afford to operate pursuant to The Pharmacy Agreement. Unlike the small independent pharmacy, the large chains often view the prescription counter as a peripheral item — the sale of prescription pharmaceuticals is a "loss-leader" to attract customers into the store where they can purchase other items while waiting for their prescriptions to be filled.[5] To the small independent retail pharmacist, on the other hand, dispensing prescriptions is the essence of his business. The profits derived from this service are the basis of his income and enable him to continue operating as a businessman.

In addition to fixing the retail sales price for pharmaceuticals at a level that denies the small independent pharmacist a profit, The Pharmacy Agreement sets the retail sales price for pharmaceuticals at a level that eliminates the small independent pharmacies' one effective means for

[5] In a recent newspaper advertisement, Petitioner Sommers advertised the following items for sale in its discount "drug stores": Spalding Tennis Set, Golden Ram Golf Balls, Delux Car Caddy with CB Mike Holder, beach towels, plastic coated playing cards, The Shower Massage by Water Pik, Casio LC-88 thin electronic calculator, Schlitz beer, Lone Star beer, Gallo Hearty Burgandy, Swinger II Bar-B-Que Grill, an Hibachi, 3-pc. Bar-B-Que tool set, garden tools, 2 gallon gas can, Donald Duck sprinkler, sprinkler assortment, Kodak Extra I Camera Outfit, Dana Solid Cologne, Aviance Spray Cologne, 6 pack cans of Coke and Sprite, Fritos Corn Chips, 48 quart ice chest, GAF 126 12 exposure color film, Cozy Cup holder, coloring books, Right Guard Deodorant, Schick Super II Razor, L'Oreal Preference Shampoo and Revlon Nail Polish. San Antonio Express, June 6, 1978, at 9-A.



competing with the large chains — the provision of services. Signatories of The Pharmacy Agreement are limited to the same retail sales price whether they provide home deliveries, twenty-four hour-a-day emergency service, patient profile cards to monitor drug usage, patient advice,[6] or no service at all (Johnson Depo. at 55, App. 155a). Since the sales price is set by The Pharmacy Agreement at a level that does not enable the small independent pharmacies to provide extra services, their ability to compete is effectively destroyed.

The Pharmacy Agreement's vice is not solely the elimination of price competition. It eliminates competition in services as well and constitutes a per se violation of Section 1 of the Sherman Act, 15 U. S. C. §1 (1970). Each of the Petitioner pharmacy chains has executed one or more Pharmacy Agreements (Johnson Depo. at 68, App. 156a-157a), and otherwise combined and conspired with Blue Shield, and with each other, to fix the retail sales prices for prescription pharmaceuticals.

Blue Shield's plan of operation does not encompass merely the fixing of the Petitioner pharmacy chains' prices. It contemplates the fixing of retail sales prices in the retail pharmacy industry generally through coercion of the small independent pharmacies. The small independent pharmacies are given the choice of either signing the price fixing

[6] Pharmacies vary in the amount of professional advice they provide prescription patients. Some merely dispense pharmaceuticals with little or no patient contact. Others give the advice needed to insure the patient takes the medication at the proper time and in the proper regime to obtain full therapeutic effects; advice to prevent the patient's ingesting other drugs or foods that will alter the effect of the medication, either potentiating or nullifying the effects; advice that will insure the patient's recognition of untoward effects of medications; and myriad other forms of advice, including merely a sympathetic ear.

agreement or being eventually forced from business. In reality, the choice is no choice, since the result of their signing the price fixing agreement is also eventual elimination.

The coercion of the small independent pharmacies is clearly economic in nature and is brought about by the Petitioners' conspiracy to effect a boycott by Blue Shield's subscribers of the non-signing pharmacies and by their conspiracy to foreclose such pharmacies from a substantial portion of the market. A pharmacy that refuses to sign the price fixing agreement is effectively foreclosed from making further pharmaceutical sales to Blue Shield's subscribers, who are coerced not to patronize the non-signer.

Coercion of the subscriber is two-pronged. First, the subscriber receives markedly reduced benefits if he patronizes a pharmacy that refuses to sign the price-fixing agreement. While he is required to pay only a Two Dollar ($2.00) drug deductible for each prescription filled by a "participating" pharmacy, he must ultimately pay an amount representing 25% of a "reasonable charge" for the drug, "as determined by Blue Shield Shield," in addition to the Two Dollar ($2.00) drug deductible, for each prescription filled by a non-signing pharmacy. (Article III of McDonald Depo. Exhibit 39, App. 315a-316a). This monetary penalty for patronizing a pharmacy that refuses to sign the price fixing agreement arises because Blue Shield will reimburse the subscriber only 75% of a "reasonable charge" for the drug, "as determined by Blue Shield," less the $2.00 drug deductible, when non-signing pharmacies are patronized. *Id.* Deposition testimony revealed no studies by Blue Shield that would justify this differential in benefits. Johnson Depo. at 27, App. 148a).



Obviously, the differential in benefits is intended to coerce Blue Shield's policyholders not to patronize non-signing pharmacies in Texas and thereby to coerce such pharmacies to sign the price fixing agreement. This purpose of coercion is graphically illustrated by Article III, Paragraph B of the Prescription Drug Insurance Policy, which provides that the subscriber will be reimbursed *100% of a "reasonable charge"* for the drug, less the $2.00 drug deductible, *when he patronizes a non-signing pharmacy outside the State of Texas.* (McDonald Depo. Exhibit 39, App. 316a; Johnson Depo. Exhibit 2 at III-7, App. 184a). There could be no reason for distinguishing between non-signing pharmacies inside versus those outside Texas, other than the fact that coercion of the latter would serve no useful purpose for Blue Shield. It would not be feasible to contract with all of the pharmacies outside of Texas.

Petitioners attempt to justify the differential in benefits by arguing that "[t]he administrative costs of processing claims for drugs purchased from non-participating pharmacies are higher than for those purchased from participating pharmacies." (Brief for Petitioners at 5, n.5). If Blue Shield's motivation were truthfully higher administrative costs, then benefits should be the same for prescription drugs purchased at non-signing pharmacies outside or inside Texas. It is curious that Blue Shield could think of this excuse for discriminating in benefits when writing its brief while Judith Johnson, Assistant Vice President of Medical Administration responsible for administration of the Blue Shield Prescription Drug Program, could not think of a reason for the discrimination in benefits while giving her oral deposition. (Johnson Depo. at 27, 34-35; App. 148a, 151a.)

The argument concerning higher administrative costs is a red herring that has been carefully orchestrated by Petitioners. To the extent they exist, the higher administrative costs have been intentionally created and perpetuated by Blue Shield's refusal to deal with pharmacies that will not agree to fix prices. By refusing to deal with pharmacies that will not sign the price fixing agreement, Blue Shield gives itself an excuse to discriminate in benefits and thereby pressure its subscribers to boycott non-signing pharmacies.

Blue Shield's refusal to deal with non-signing pharmacies provides Petitioners with an additional and more subtle tool with which to coerce Blue Shield's subscribers and thereby effectuate a boycott of non-signers. If a pharmacy signs The Pharmacy Agreement and thereby agrees to charge only the stipulated amount for pharmaceuticals sold to Blue Shield's subscribers, it will be reimbursed by Blue Shield in the amount of its acquisition cost for the drug, and the subscriber will be obligated to personally pay the pharmacy at the time of purchase only the Two Dollar ($2.00) drug deductible (in effect, the "professional dispensing fee"). (Paragraph 4 of Johnson Depo. Exhibit 19, App. 210a-202a, and Johnson Depo. Exhibit 2 at p. II-7, App. 175a-176a). However, when a pharmacy refuses to sign the price fixing agreement, Blue Shield will not deal with the pharmacy directly, and the subscriber must pay the entire retail sales price at the time of purchase rather than merely the Two Dollar ($2.00) deductible that he would pay a participating pharmacy. (Johnson Depo. Exhibit 2 at p. II-7, App. 175a-176a). After paying the entire sales price at the time of purchase, he must file a claim with Blue Shield seeking reimbursement (which will equal only seventy-five percent (75%) of a "reasonable charge" for the drug, "as determined by Blue Shield," less the Two



Dollar ($2.00) drug deductible. (Johnson Depo. Exhibit 39 at Article III.B, 316a).

The pressures exerted on the subscriber are obvious. If he patronizes a pharmacy that has signed the price fixing agreement, he does not tie up his money during the often long interval that passes in obtaining reimbursement from Blue Shield. Additionally, he avoids the administrative burden of his filing a claim for reimbursement. That these pressures are aimed at coercing the subscribers not to patronize the non-signing pharmacies, and thereby to coerce such pharmacies to sign the price fixing agreement, cannot be doubted. Regardless whether the subscriber patronizes a signing or non-signing pharmacy, the same claim form is utilized (Helis Depo. at 15, App. 282a; Johnson Depo. Exhibit 2 at p. III-4, App. 180a); the same information is necessary to its completion; and the pharmacist's assistance is needed in providing this information. (Johnson Depo. Exhibit 2 at p. III-4 to III-6, App. 180a-184a). Indeed, the claim form itself directs the insured to have the non-participating pharmacy complete the prescription information section (Johnson Depo. Exhibit 2 at p. III-4, App. 180a-181a). Thus, since the pharmacy must participate in claims administration in both instances, no purpose is served by Blue Shield's refusal to deal directly with non-participating pharmacies other than the harassment of its policyholders. When the policyholder files his own claim, it is more involved for him than if he had patronized a participating pharmacy, who would file the claim for him, and he must await reimbursement. (Helis Depo. at 22-23, App. 285a-286a).

Although Petitioners claim that "Blue Shield's insureds are *entitled* to obtain prescription drugs from any pharmacy

they choose,"[7] it is a rare subscriber indeed who is willing to accept reduced benefits and to undergo an administrative burden in order to patronize the pharmacy of his choice. Since the Prescription Drug Insurance Policy gives the subscriber far more monetary and administrative benefits when he patronizes a Participating Pharmacy than when he patronizes a pharmacy that has refused to to sign the price fixing agreement, he is subtly, but actually, coerced to purchase pharmaceuticals solely from Participating Pharmacies.

The effectiveness of this coercion is documented. Of the 31,000 prescription claims per month processed by Blue Shield in late 1975, approximately 600 per month, or *merely 1.9%*, represented prescriptions filled by non-participating pharmacies. (Helis Depo. at 10, 13; App. 281a-282a). Thus, through the aforementioned methods of coercion, Petitioners have effectively allocated to the signatories of the price fixing agreement *over 98%* of all sales of prescription pharmaceuticals to Blue Shield's subscribers. The program of coercion effectively forecloses the non-signing pharmacies from a substantial portion of the market and, therefore, constitutes an unreasonable restraint of trade in violation of Section One of the Sherman Act. 15 U.S.C. §1 (1970).

The Petitioner pharmacy chains play a central role in the conspiracy to set the retail sales prices of pharmaceuticals, the conspiracy to effect a boycott of Respondents, and the conspiracy to foreclose Respondents from a substantial portion of the market. It is only through the participation of the Petitioner pharmacy chains that the small independent pharmacies can be whipsawed into agreeing to fix their retail sales prices.

[7] Brief for Petitioners at 4 (emphasis added).



By combining with the Petitioner pharmacy chains, who have many outlets, Blue Shield has guaranteed that its subscribers will not have to choose between geographical inconvenience and reduced policy benefits when deciding whether to patronize a non-signing pharmacy. The subscriber will generally find one of the Petitioner chains' outlets to be readily accessible. The large chains help guarantee that the sole factors in the subscriber's mind will be the markedly reduced policy benefits and administrative inconvenience he will receive if he patronizes a non-signing pharmacy.

Blue Shield has consciously utilized these factors as can be seen in its inter-office correspondence. When a particular large drug chain, Sommers, decided to join the price fixing conspiracy, one member of Blue Shield's management admitted, "Our entire Foundation Program [Bexar County] would not have been successful without them. . . ."[8] (Johnson Depo. Exhibit 13, App. 199a; Johnson Depo. at 61, App. 156a). *See also*, Johnson Depo. Exhibit 12, App. 198a.

### B. Respondents' Answer to Petitioners' "History of the Drug Insurance Program"

Petitioners seek to avoid scrutiny of their activities under the Sherman Act by alleging that their conduct merely is the "business of insurance" and falls within the protective umbrella of the McCarran-Ferguson Act (McCarran Act), 15 U. S. C. §§1011, *et seq.*, (1970). In furtherance of this thesis, Petitioners make numerous erroneous representations concerning the extent and types of regulation to which their activities have been subjected by the State of Texas.

[8] At the time Judith Johnson's deposition was taken in 1975, Petitioner Sommers had twenty-five (25) stores in San Antonio, Texas. (Johnson Depo. Exhibit 17, Johnson Depo. at 62-63, 66).

Petitioners obviously desire to create the impression that their challenged activities are considered part of the "business of insurance" by the State of Texas and have been regulated as part of that business. Such is not the case!

The most blatant misstatements of fact set forth in Petitioners' brief are Petitioners' assertions that the State Board of Insurance and/or its Commissioner have "authorized", "approved", and "regulated" The Pharmacy Agreement and its attendant price fixing activities. *See* Brief for Petitioners at 7, 8, 31-35. Petitioners assert that Blue Shield filed the Prescription Drug Insurance Policy *and* The Pharmacy Agreement with the Texas State Board of Insurance "for approval." (Brief for Petitioners at 7). They assert that in 1969, the State Board issued an order "disapproving" The Pharmacy Agreement. *Id.* at 7, 33. Further, they state that following disapproval The Pharmacy Agreement remained under consideration by the State Board, with "authorization" for its issuance and use coming in September, 1969. *Id.* They represent that The Pharmacy Agreement has been subjected to "pervasive regulation" by the Texas State Board of Insurance.

Petitioners' statements in this regard are utterly erroneous, have no foundation in fact, and are misleading. Although Petitioners make numerous allegations concerning The Pharmacy Agreement's being "regulated" and subject to "pervasive regulation," they fail to show a *single example* of such "regulation." Petitioners are trying to create the illusion that The Pharmacy Agreement and, more specifically, its attendant price fixing in the pharmaceutical industry are considered by Texas to be within the jurisdiction of the State Board of Insurance and thus a part of the business of insurance.



The Pharmacy Agreement and its attendant price fixing have never been approved, authorized, nor regulated by the Board. The Board has never purported to have authority or jurisdiction to authorize or regulate The Pharmacy Agreement nor Blue Shield's price fixing conspiracies with pharmacies. In this regard, it is crucial that the Court distinguish between the Prescription Drug Insurance Policy (McDonald Depo. Exhibits 37, 39; App. 303a-318a) and The Pharmacy Agreement (Johnson Depo. Exhibit 19, App. 200a-204a) when reviewing Petitioners' brief in order that it is not misled into thinking that the latter document had been approved, authorized, or regulated.

Blue Shield endeavors to create the illusion of State regulation by stating the following:

> In March, 1969, in compliance with the requirements of Article 3.42 of the Texas Insurance Code, TEX. INS. CODE ANN. art. 3.42 (Supp. 1977) . . ., Blue Shield filed the proposed policy *and the annexed Pharmacy Agreement* with the Texas State Board of Insurance ("State Board") *for approval.* (Brief for Petitioners at 7) (emphasis added).

By stating that The Pharmacy Agreement was submitted *for approval* in March, 1969, Blue Shield is trying to create the illusion that The Pharmacy Agreement is within the jurisdiction of the State Board of Insurance and regulated as a part of the business of insurance in Texas. It is obviously trying to create the impression that The Pharmacy Agreement must be submitted to the Board for approval prior to its use. Such is not the case!

Article 3.42 merely requires the filing of the "forms" of the "policy, contract, or certificate of . . . group hospitalization insurance, medical or surgical insurance, group medical

or surgical insurance. . . ." TEX. INS. CODE ANN. art 3.42 (Supp. 1977). Nowhere does it require the filing of The Pharmacy Agreement nor an equivalent document. There are no Texas statutes that require The Pharmacy Agreement to be submitted to the State Board of Insurance "for approval" or for any other reason.

Blue Shield is well aware that The Pharmacy Agreement does not have to be submitted to the State Board "for approval." Steve G. McDonald, house counsel for Blue Shield (McDonald Depo. at 4, App. 288a), and the individual who supposedly submitted The Pharmacy Agreement to the State Board of Insurance in March, 1969, "for approval", admitted in his oral deposition that approval of the State Board of Insurance is not required with respect to use of The Pharmacy Agreement. (McDonald Depo. at 57, App. 302a). He further admitted that The Pharmacy Agreement was "filed with the Insurance Board for informational purposes," not for approval. *Id.* Indeed, Blue Shield's March, 1969, transmittal letter to the Board itself demonstrates that The Pharmacy Agreement was not submitted "for approval." The only document submitted "for approval" in the letter was Form No. CC-OHDS-2, the Prescription Drug Insurance Policy. (Pogue Depo. Exhibit 51, App. 352a-353a).

The allegations set forth in Petitioners' brief concerning "approval" and "authorization" of The Pharmacy Agreement merely are a continuation of the charade Blue Shield has endeavored to perpetuate since its first contemplated use of The Pharmacy Agreement to fix prices. This charade is graphically illustrated by some early correspondence between the president of Blue Shield of Texas and an official of the National Association of Blue Shield Plans



concerning preparation of what was to become Blue Shield's Pharmacy Agreement. *See* Johnson Depo. Exhibit 32, App. 276a-277a. A copy of this exhibit is reproduced as Addendum ("Add.") No. 1 to this brief.

As the correspondence illustrates, there was concern with the antitrust problems that would be generated by an agreement between Blue Shield and retail pharmacies, the effect of which would be to fix prices in the retail pharmaceutical industry. It was suggested that the price fixing agreement with pharmacies be camouflaged under the guise that it was a "mass accounting agreement." It was further suggested that Blue Shield might avoid federal antitrust scrutiny by drafting the price fixing agreement in such manner that it would have to be filed with the State Board of Insurance — thereby creating the illusion that it was part of the business of insurance regulated by the State Board.

> I think it would be best to draft the contract so that the Insurance Board would require filing of the mass accounting agreement [The Pharmacy Agrement] *to strengthen your base on antitrust*. Drafting problems will get sticky here, but let's pass on that for now. (Johnson Depo. Exhibit 32, App. 276a-277a, Add. 1) (emphasis added).

From the very beginning, Blue Shield has known that its price fixing activities are outside the business of insurance and subject to antitrust scrutiny.

Despite Blue Shield's machinations and its atempts to manipulate the McCarran Act to its advantage, the State Board of Insurance has left little doubt it does not consider The Pharmacy Agreement and its attendant price fixing to be a part of the business of insurance and that it does not consider The Pharmacy Agreement to be within its juris-

diction. Contrary to the representations on page 7 of Petitioners' brief, the State Board of Insurance did not disapprove The Pharmacy Agreement in 1969. Order No. 29701 by the Commissioner of Insurance on June 18, 1969, while disapproving Blue Shield's Prescription Drug Insurance Policy, made absolutely no mention of The Pharmacy Agreement Blue Shield gratuitously submitted therewith, nor of the price fixing activity contemplated by The Pharmacy Agreement. (Pogue Depo. Exhibit 53, App. 365a-366a). In discussing the problems raised by Blue Shield's Prescription Drug Insurance Policy, the Order makes no mention of The Pharmacy Agreement's being within the ambit of TEX. INS. CODE ANN. art. 21.21.

There is no doubt regarding the reasons underlying the Commissioner's silence about The Pharmacy Agreement. As is demonstrated by the deposition testimony of A. W. Pogue, Division Manager, Policy Approval Division of the State Board of Insurance,[9] contracts between an insurance company and a pharmacy, such as The Pharmacy Agreement, *are not* subject to the authority or control of the State Board of Insurance. When he was asked whether the State Board has "any jurisdiction over independent pharmacists in the State of Texas", Mr. Pogue answered,

> That is outside of our regulatory control. To the best of my knowledge, I know of no statutory jurisdiction over a pharmacy." (Pogue Depo. at 53, App. 339a-340a).

He testified further that the State Board of Insurance does not in any manner regulate pharmaceutical operations. (Pogue Depo. at 58, App. 342a). When asked whether The Pharmacy Agreement (Pogue Depo. Exhibit 6, App. 348a-

[9] Pogue Depo. at 3-4, App. 319a.



351a) would be a document subject to the regulatory authority of the State Board of Insurance, Mr. Pogue stated unequivocally,

> I do not feel that a contract of that nature falls within the *jurisdiction* of the State Board of Insurance. (Pogue Depo. at 68) (emphasis added).

Along these same lines, the following exchange took place:

> Q: [By Mr. Pullen] If pharmacies should enter into contracts with insurance companies such as Blue Shield, in your opinion, is that contract subject to regulation by the State Board of Insurance?
>
> A: [By Mr. Pogue] In my personal opinion I do not feel that it is a contract that would require approval of the State Board of Insurance. (Pogue Depo. at 58-59, App. 343a).

The Pharmacy Agreement does not fall within the jurisdiction of the State Board of Insurance and does not require the Board's approval because it does not constitute the business of insurance. If the agreement did constitute the business of insurance, it would be within the jurisdiction of the State Board since, as Mr. Pogue testified,

> [t]he Legislature gives us [The State Board of Insurance] regulatory authority over anything that encompasses insurance in the State of Texas. (Pogue Depo. at 66, App. 345a). If there is an insurance function involved, then the State Board would be in a regulatory position on the case. (Pogue Depo. at 66, App. 346a).

Counsel for Blue Shield elicited the same response from Mr. Pogue concerning The Pharmacy Agreement.

> Q: [By Mr. Kaiser] If it were determined by the Commissioner of Insurance that a drug service contract

such as the one you have been looking at here this morning with a participating pharmacist did constitute the business of insurance, would the State Board of Insurance have regulatory authority then?

A: [By Mr. Pogue] If we deemed that the use of *any type contract* did constitute the business of insurance, then the State Board of Insurance would look at it from a regulatory — [Interrupted by counsel for Blue Shield at this point].

Q: [By Mr. Kaiser] Thank you. I have no further questions. (Pogue Depo. at 69, App. 347a) (emphasis added).

As is shown by Mr. Pogue's testimony, the State Board of Insurance does not consider The Pharmacy Agreement to encompass or constitute the business of insurance. As Mr. Pogue testified, The Pharmacy Agreement is deemed merely to "constitute a contract between an entity and a pharmacy for the furnishing of services." (Pogue Depo. at 54, App. 340a). There is nothing special about this relationship that would subject it to the jurisdiction of the Board of Insurance nor make it a part of the business of insurance. The agreement and conspiracy between Blue Shield and the Defendant pharmacy chains to fix the retail sales prices of pharmaceuticals is not a part of the business of insurance.

The only evidence in the record that even remotely contradicts the testimony of the present Director of the Policy Approval Division is the response by Paul D. Connor, a former employee of the State Board of Insurance,[10] to a convoluted question regarding the exemption of Blue Shield's Prescription Drug Insurance Policy form. In September,

[10] Mr. Connor currently is an attorney with a law firm that represents "fifty . . . or more" insurance companies. (Connor Depo. at 30-31, App. 406a-407a).



1969, the State Board of Insurance exempted the Prescription Drug Insurance Policy form (and only this form) from the approval requirements of TEX. INS. CODE ANN. art. 3.42. With regard to this exemption, the following exchange took place between counsel for Blue Shield and Mr. Connor:

Q. [By Mr. Kaiser] . . . Mr. Conner, at the time of the issuance of this Exemption Order that you are looking at right now, was it your opinion that this particular contract which is marked Deposition Exhibit 52 [the Prescription Drug Insurance Policy], along with the Participating Drug Pharmacy Agreement which Blue Shield proposed to issue, was it your opinion *that that* constituted the business of insurance?

A: [Mr. Conner] Yes. (Conner Depo. at 13, App. 394a) (emphasis added).

A possible conclusion to be drawn from this exchange is that Mr. Connor, unlike Mr. Pogue, considered The Pharmacy Agreement to be a part of the business of insurance. However, the naming of the Prescription Drug Insurance Policy and The Pharmacy Agreement in separate clauses, followed by the phrase "that that" rather than "that these", leaves the issue in doubt. It is entirely likely that Mr. Connor understood the phrase "that that" to refer only to the Prescription Drug Insurance Policy. This construction is highly probable when one notes that immediately prior to the above-mentioned exchange, Mr. Connor testified that he did not recall having had occasion to review The Pharmacy Agreement before drafting the exemption order and that he has "no recollection of reading the document [The Pharmacy Agreement]." (Connor Depo. at 12-13, App. 393a-394a).

The testimony of Mr. Connor is weak evidence indeed for the proposition that the State Board regards The Pharmacy

Agreement to be part of the business of insurance.[11] Against this construction is the unambiguous testimony of the present Division Manager of the Policy Approval Division of the State Board of Insurance.

Blue Shield's own conduct demonstrates it is not serious when it alleges that The Pharmacy Agreement is within the jurisdiction of the State Board of Insurance. When Blue Shield desired to implement prescription drug insurance coverage in Bexar County, Texas in 1974, it submitted to *Mr. A. W. Pogue* of the State Board of Insurance (the individual whose deposition testimony Blue Shield wishes this court to ignore!) various documents *for approval.* (Pogue Depo. Exhibits 57 and 59, App. 374a-384a). Significantly, Blue Shield did not bother to submit The Pharmacy Agreement *for approval* with these documents, and the Commissioner's subsequent Order No. 45511 made no mention of The Pharmacy Agreement. (Pogue Depo. Exhibit 61, App. 385a-386a).

If Article 3.42 requires that The Pharmacy Agreement be submitted for approval as Blue Shield contends, then why was the document not submitted "for approval" in 1974? Blue Shield did not to submit The Pharmacy Agreement in 1974 because it knew the document is not within the jurisdiction of the State Board of Insurance and its filing is not required by article 3.42 of the Insurance Code.

Blue Shield desires to create the impression that the Attorney General of the State of Texas has scrutinized The

[11] Yet based on this testimony, Petitioners made the following unqualified assertion:

> The former Deputy Commissioner of the State Board testified in this case that Blue Shield's drug policy *and Pharmacy Agreement* constitute the business of insurance, and are subject to the full regulation, control and supervision of the State Board. (Brief for Petitioners at 32) (emphasis added).



Pharmacy Agreement for possible antitrust violations by asserting that after the Commissioner of Insurance issued Order No. 29701 disapproving the Prescription Drug Insurance Policy form, "[t]he policies *and Pharmacy Agreements* here in issue were referred by the State Board, after its review, to the Texas Attorney General for consideration under the state antitrust statutes." (Brief for Petitioners at 34, n. 30.) (emphasis added). In truth, the Board did not provide the Attorney General with a copy of The Pharmacy agreement as contended by Petitioners. Rather, as demonstrated by the Commissioner's transmittal letter to the Attorney General (Pogue Depo. Exhibit 54, App. 367a-369a), the Commissioner provided the Attorney General with a copy of the Prescription Drug Insurance policy, "Form CC-OHDS-2", and *not* a copy of The Pharmacy Agreement, "Form PDPA-1". The Commissioner did not mention Blue Shield's price fixing activities either.

In its efforts to convey the impression that the activities challenged by Respondents are considered by Texas to be a part of the business of insurance, Blue Shield makes several plays on words. In this connection, Respondents direct the Court's attention to Blue Shield's use of the term "program". Use of this term is a ploy by Blue Shield to create the impression that the Commissioner of Insurance and the Attorney General of the State of Texas have somehow determined that Blue Shield's challenged activities constitute the "business of insurance" and have been "aggressively regulated" as such. Blue Shield uses the nebulous term "program" to imply that all of its activities, including those challenged herein, were studied, considered, approved, or regulated by the various State officials or agencies discussed. This is incorrect. Each time Blue Shield uses the term "program", this Court must determine exactly what

activity(ies), contract(s), policy(ies), or document(s) actually were being studied, considered, approved, authorized, or regulated by the particular State official or agency in question. In no instance where the nebulous term "program" is used was The Pharmacy Agreement and its attendant price fixing approved, regulated, authorized or in any manner treated as a part of the business of insurance in Texas.

A graphic example of this misleading use of the term "program" is seen on page 34 of the Petitioners' brief. The assertion is there made that "the proposed insurance *program* remained under consideration by the State Board and the Commissioner subsequently authorized the *program.*" (Brief for Petitioners at 34) (emphasis added). This statement is entirely false, lacks support in the record, and directly contradicts the testimony of Mr. A. W. Pogue insofar as it suggests The Pharmacy Agreemest and its attendant price fixing were "authorized." It is curious indeed that Blue Shield can claim the State Board of Insurance has "authorized" that which is not even within the Board's *jurisdiction* according to the Director of the Policy Approval Division.

As Director of the Policy Approval Division of the State Board of Insurance, Mr. Pogue is the official charged with reviewing the documents within the Board's jurisdiction "to make sure that they comply with statutory requirements as set forth in the Insurance Code or that they comply with rules and regulations promulgated by the Board or by the Commissioner" (Pogue Depo. at 13, App. 324a-325a). Mr. Pogue's testimony set forth above shows The Pharmacy Agreement is not within the jurisdiction of the State Board of Insurance and that it neither requires nor is subject to the Board's approval or authorization. It is



shocking that Blue Shield continually makes the unsupported assertion that it has been entering into Pharmacy Agreements with Participating Pharmacies pursuant to the Commissioner's authorization. If such authorization had been given, Mr. Pogue would have been the first to know of it!

In claiming that its "program" has been "authorized" by the State Board of Insurance, Blue Shield is being more subtle than it was in its brief before the Fifth Circuit where it alleged the following:

> [Since October 1, 1974] Blue Shield has been . . . entering into Pharmacy Agreements with Participating Pharmacies pursuant to the *approval* granted by the Commissioner [of Insurance]. (Brief of Appellee Group Life and Health Insurance Company at 26) (emphasis added).

Apparently, Blue Shield has been motivated to utilize innuendo rather than outright statements by the knowledge that this Court will review the record as did the Fifth Circuit and reach the same conclusion as the latter.

> It is clear from the record that the Board has never approved the Pharmacy Agreement, and the Division Manager of the Board's Policy Approval Division, a Mr. Pogue, testified that he thought the Pharmacy Agreement was outside the State's regulatory control. (App. 133a)

It is difficult to conceive how a State agency can "authorize" that which is outside its jurisdiction and regulatory control. No amount of semantic manipulations can get around the unambiguous testimony of Mr. Pogue on this subject.

Q: [By Mr. Pullen] To your knowledge, has the State Board of Insurance ever approved Deposition Exhibit 6 [The Pharmacy Agrement] or any similar document?

A: To my knowledge, no, we have not.
[Pogue Depo. at 55, App. 341a).

Q: [By Mr. Pullen] Well, so that the record will be clear, is it your understanding that the State Board of Insurance under the regulatory authority granted it under the Texas Insurance Code has authority to regulate contracts between a company such as Blue Shield and an independent Pharmacy?

A: My own personal opinion is that this particular contract that you just showed me —

Q: [By Mr. Pullen] You are talking about Deposition Exhibit 6 [The Pharmacy Agreement]?

A: Right. Would be a contract between an entity and a provider *which would not be a part of the original or full contract of insurance.* The contract would be filed with us for informational purposes which would be part of a plan of operations, but when we get an entire plan of operations in, there are certain aspects of it that we file [such as The Pharmacy Agreement], certain aspects of it that we approve. (Pogue Depo. at 56, App. 341a-341a) (emphasis added).

Q: [By Mr. Pullen] If pharmacies should enter into contracts with Insurance companies such as Blue Shield, in your opinion, is that contract subject to regulation by the State Board of Insurance?

A: In my opinion I do not feel that it is a contract that would require approval of the State Board of Insurance. (Pogue Depo. at 58-59, App. 343a).

The Commissioner's Order No. 45511, dated October 1, 1974, while approving the Prescription Drug Insurance Policy form, "Form MF-1-DS-1", makes absolutely no mention of The Pharmacy Agreement (Pogue Depo. Exhibit 61, App. 385a-386a). The latter document was neither "approved" nor "authorized" in that or in any other order emanating from the Commissioner's office. The Pharmacy Agreement and its attendant price fixing are not considered by the Board to be a part of the business of insurance in Texas.



Only one order from the State Board of Insurance even mentions The Pharmacy Agreement, and that order does so in a peripheral manner that could in no sense be deemed an "authorization." Order No. 30413, dated September 30, 1969 (Pogue Depo. Exhibit 55, App. 370a-371a), exempts Blue Shield's Prescription Drug Insurance Policy form from the approval requirements of TEX. INS. CODE ANN. art. 3.42, but does not exempt The Pharmacy Agreement from anything nor in any manner "authorize" use of The Pharmacy Agreement. The exemption order provides in pertinent part as follows:

> "Pursuant to the authority granted by Article 3.42, Paragraph (e) of the Texas Insurance Code, the Commissioner of Insurance hereby exempts from the requirements of said Article *Policy Form CC-OHDS-2* [the Prescription Drug Insurance Policy form]. . . . This exemption order shall also apply to any form, *identical in content to Form CC-OHDS-2*, delivered, issued or used in this state by any licensed insurer [which would not include the Pharmacy Agreement, form PDPA-1.] . . . The *exempt forms* are described as *drug service contracts*, which confer upon the policyholder the right to obtain certain prescribed drugs at a cost [the deductible] fixed in the contract, the insurer having entered into participating agreements with dispensing pharmacies to supply the prescribed drugs to its policyholders. (Emphasis added).

Obviously, the Order merely "authorizes" use of the prescription Drug Insurance Policy form. Its sole reference to The Pharmacy Agreement is worded in such manner as to illustrate the Commissioner's feeling that The Pharmacy Agreement is outside his authority:

> ". . . the insurer *having entered* into participating agreements with dispensing pharmacies . . . (Emphasis added).

"Pervasive regulation" of The Pharmacy Agreement, its attendant price fixing, and the conspiracy to effect a boycott by Blue Shield's subscribers of the non-signing pharmacies is an illusion with no basis in fact.

Another example of Blue Shield's misleading use of the term "program" is seen on page 31 of Petitioners' brief, where the following allegation is made:

> [W]ith regard to a prepaid prescription drug program *identical* in concept and operation to the Blue Shield plan, the Attorney General concluded that the insurer "would be engaging in the business of insurance, in furnishing the prescription service required by its service agreements and pharmacy contracts." (Brief for Petitioners at 31) (emphasis added).

Blue Shield would have this Court believe that activities identical to those challenged herein by Respondents were reviewed in 1962 by the Texas Attorney General and determined at that time to be the "business of insurance." Such a determination was not made!

A copy of the ruling to which Blue Shield refers, Attorney General's Opinion No. WW-1475, dated December 11, 1962, is set forth at pages 473a-482a of the Appendix. As a close reading of the Attorney General's opinion clearly demonstrates, the "program" considered by the Attorney General



not only is *not* "identical" in concept and operation to the activities challenged by Respondents herein, but *was not* considered by the Attorney General for the purpose of determining whether *each* of the activities embraced by the "program" constituted the "business of insurance."

In the "program" submitted to the Attorney General, the contracts between the insurance company and the pharmacies did not fix the pharmacies' retail sales prices. Rather, the contracts set forth the *amount that the insurer was obligated to pay*, based on a schedule of prices as provided for in the contract, and provided that the policyholder would pay the remaining one-third or one-half (the fraction as specified in the contract) of the pharmacist's "prescription selling price", *which price was not set by agreement*. (App. 476a). The pharmacist's retail selling price, on which the policyholder's payment was to be computed, was not agreed upon in the provider agreement. In the "program" before the Attorney General, the Pharmacy Contract was merely an administrative agreement setting forth the pharmacies' obligation to dispense drugs to policyholders, the mechanics for reimbursement of the pharmacies, and the insurer's obligations.

Blue Shield's "program", however, fixes prices. The *total amount* of the pharmacies' retail sales prices are fixed by Blue Shield's Pharmacy Agreement, not merely the amount that Blue Shield is obligated to pay as was the case in the "program" before the Attorney General. By no stretch of the imagination is Blue Shield's "program" "identical" in concept and operation to that before the Attorney General in 1962.

Additionally, it must be stressed that the Attorney General did not state all of the activities involved in the 1962

"program" constituted the business of insurance, as Blue Shield suggests. The Attorney General was merely determining whether a particular corporation would, under the facts presented, be considered an insurance company; *not* whether each individual activity contemplated by that corporation constituted or was a part of the business of insurance. There is a crucial distinction between these two determinations. With respect to the former, it can be determined that a particular corporation is conducting business as an insurance company despite the fact that some of its myriad actions are peripheral to, and not a part of, the business of insurance. As this Court has emphasized, "[i]nsurance companies may do many things which are [peripheral to the business of insurance and hence] subject to paramount federal regulation." *S.E.C. vs. National Securities, Inc.*, 393 U.S. 453, 460 (1960). In his 1962 opinion, the Attorney General was not engaged in the task of determining which of Prepaid Prescription Plan, Inc.'s activities were a part of the business of insurance and which were not.[12]

An examination of the Attorney General's legal analysis and of the cases cited therein leaves no doubt concerning the narrowness of his inquiry. The Attorney General emphasized such narrowness with the following observation:

> As pointed out in your opinion request, the prescription selling price upon which the subscriber's payment is computed may be different from the price upon which the corporation's payment is computed. *This, however, is not material to the question presented.* (App. 477a n.1) (emphasis added).

[12] The Attorney General restated the question that was the subject of his inquiry. "You have asked our opinion as to whether or not the business proposed to be conducted by Prepaid Prescription Plan, Inc., is an insurance business." (App. 474a).



The question to be answered was whether Prescription Plan, Inc. would be conducting a Kaiser-type plan — in which a company provides services for a fee, employs entities to provide these services, and assumes no risk — or would be acting as a true insurance company. The Attorney General merely determined that, under the facts presented, a certain corporation would be considered an insurance company for the purposes of the Texas Insurance Code. *See*, App. 476a. This determination bears absolutely no logical relevance to the question whether the activities challenged in this case constitute the business of insurance.

The question here is whether Blue Shield's challenged *activities* constitute the business of insurance. The Attorney General's opinion provides absolutely no guidance on this point.

### C. The Complaint and the Decisions Below

Petitioners erroneously attribute to Respondents the following contention:

> [T]hat in contracting with pharmacies to provide *policy* benefits to its insureds, Blue Shield was not engaged in the "business of insurance" within the meaning of the McCarran Act. (Brief for Petitioners at 9) (emphasis added).

This erroneous characterization of Respondents' claims is perpetuated throughout Petitioner's brief as a general attack on contracts between insurance companies and providers. Respondents are not attacking contracts between insurers and providers in general and are not alleging that all such contracts are outside the business of insurance.

Nor are Respondents attacking the mere fact that Blue Shield has entered into agreemcnts with pharmacies, which

agreements require the pharmacies to dispense pharmaceuticals to Blue Shield's policyholders and to look to the policyholders for direct payment of only a $2.00 drug deductible. If this were all that the Pharmacy Agreements provided, Respondents would have no complaint concerning them, and it would be true that The Pharmacy Agreements merely required the performance of obligations owed to the insureds and nothing more. However, The Pharmacy Agreements do more than merely obligate the Participating Pharmacies to dispense pharmaceuticals to Blue Shield's insureds and to look to the insureds for only $2.00 of the retail sales price. The Pharmacy Agreements go beyond this innocuous function and serve as a vehicle by which competing pharmacies conspire and agree concerning the *total price* that they will charge for dispensing pharmaceuticals to each of Blue Shield's policyholders. By virtue of The Pharmacy Agreements' price fixing provision, Blue Shield and the Petitioner Pharmacy chains are conspiring to eliminate competition in prices and services within the retail pharmaceutical industry. Contrary to Blue Shield's claims, it cannot be said that "the terms and provisions of the [prescription drug insurance] policies expressly contemplate the execution of such agreements." (Brief of Blue Shield at 17). The Prescription Drug Insurance Policy does not mention execution of agreements that serve to fix retail prices in the pharmaceutical industry.

Respondents contend that the McCarran Act does not provide a blanket exemption from the federal antitrust laws for *all* contracts between insurers and providers. When such contracts are utilized as vehicles to implement activities outside the ambit of the business of insurance, then to that extent they are subject to scrutiny under the federal antitrust laws. When an insurer combines and conspires with



retail pharmacy chains *to fix the latter's retail sales prices*, and employs a scheme of coercion to fix retail sales prices in the retail pharmacy industry generally, it has gone beyond the "business of insurance" and has stepped outside the McCarran Act's protective scope.

The Fifth Circuit followed this Court's ruling in *S.E.C. v. National Securities, Inc.*, 393 U.S. 453 (1969), and refused to grant blanket antitrust immunity for any and all activities embraced or implemented by contracts between insurers and providers of benefits. It followed the correct legal standard by analyzing the challenged activities to determine whether, absent their camouflage, they are a part of the "business of insurance," and noted that "[anticompetitive practices] do not become clothed with McCarran Act protection simply because an insurance company has contracted to pay the provider for goods or services." (App. 137a, 556 F.2d at 1386). The Fifth Circuit concluded "there is no . . . indication that the activities complained of are considered the business of insurance by the State or by any common sense interpretation of that term." (App. 135a, 556 F.2d at 1385).

## SUMMARY OF ARGUMENTS

I. Petitioners' activities in conspiring and agreeing to fix the retail sales prices of pharmaceuticals, in conspiring to effect a boycott of pharmacists who refuse to agree on retail sales prices and in conspiring to foreclose pharmacists who refuse to agree on prices from a substantial portion of the market do not constitute the "business of insurance" in Texas and are not regulated as part of such business. The McCarran-Ferguson Act's (McCarran Act's) focus is on the relationship between the insurance company and the

insured. When the connection between challenged activities and this relationship is attenuated, as it is here, the challenged activity does not constitute the business of insurance. Since Petitioners' activities eliminate competition between retail pharmaciees with respect to prices and customer services, they primarily relate to the relationships between competing pharmacies and between such pharmacies and their customers. Any effects on the relationship between Blue Shield and its policyholders are merely peripheral and canot serve to invoke the McCarran Act.

The fixing of retail sales prices for pharmceuticals and the coercion of independent pharmacies to fix their prices are not obligations owed by Blue Shield to its policyholders under the Prescription Drug Insurance Policy. Blue Shield's sole obligation to each policyholder is to see that he is able to procure prescription drugs *at a cost to the policyholder* of only $2.00 per prescription (the drug deductible). Blue Shield utilizes price fixing to gain a degree of control over the magnitude of individual claims. Rather than control the maximum amount of individual claims through its contractual relationship with policyholders, Blue Shield has sought to control the dollar amount of individual claims by fixing the retail sales prices for pharmaceuticals in the pharmaceutical industry. By acting in this manner, Blue Shield has gone beyond the business of providing prescription drug insurance and has encroached on the business of selling prescription pharmaceuticals. The McCarran Act does not shield from antitrust scrutiny an insurance company's efforts to control the magnitude of its policyholders' claims through the elimination of competition in those industries providing goods and services for which benefits are payable under the insurance policy.



The McCarran Act does not give automatic antitrust immunity to every activity embraced or contemplated by a direct contractual relationship between an insurance company and providers of benefits that relates in some manner to the provision of benefits. Federal courts must look beyond labels and camouflage to see whether the particular activities constitute the business of insurance. Price fixing conspiracies between insurers and providers of benefits do not constitute the business of insurance and are not within the McCarran Act's protective scope. The McCarran Act does not apply *ipso facto* to every activity embraced or contemplated by a direct contractual relationship between an insurance company and a provider of benefits, which relates in some manner to the provision of benefits. Price-fixing agreements between insurers and the providers of benefits do not constitute the business of insurance and are not within the McCarran Act's protective scope.

The Texas State Department of Insurance does not consider The Pharmacy Agreement nor Petitioners' attendant price-fixing activities to encompass or constitute the business of insurance and has not undertaken to regulate the agreement or activities as a part of such business. When a State makes the determination that an activity does not constitute the business of insurance, and thereby serves notice that the activity will not be regulated as a part of business of insurance, as the Texas State Department of Insurance has done with respect to Blue Shield's Pharmacy Agreement, that determination should be controlling with the federal courts. A contrary holding by the federal courts violates the Supreme Court's mandate that the various exemptions from the antitrust laws are to be strictly construed.

II. Petitioners are pursuing a private system of wage-price controls with respect to the retail pharmaceutical industry. Texas does not regulate Petitioners' challenged activities as a part of the business of insurance. Congress did not intend that the McCarran Act be utilized to institute a system of *private regulation* by insurers and their co-conspirators, with mere tacit approval by the States. Since Petitioners' activities are conducted entirely without the safeguards of a State scheme of administrative supervision, they are subject to scrutiny under the federal antitrust laws.

III. The existence of boycott, coercion, and intimidation preclude the existence of McCarran Act immunity in this case. Section 3(b) of the McCarran Act dictates that an insurer's acts in coercing, intimidating, and effecting boycotts of independent retail pharmacists are removed from the Act's protective scope.

IV. The Petitioner pharmacy chains cannot invoke the McCarran Act to immunize their activities from antitrust scrutiny. When applicable, the McCarran Act only serves to exempt insurance companies and their agents or employees from federal regulation with respect to their activities constituting the business of insurance. Entities other than insurers, their agents, or their employees cannot engage in the "Business of insurance", and the McCarran Act does not insulate them from the federal antitrust laws merely because they may deal with insurers in some capacity.

Even if Blue Shield were able to immunize itself from the federal antitrust laws with respect to the activities challenged herein through reliance on the McCarran Act, the Petitioners pharmacy chains could be held accountable under the antitrust laws for their activities in combining and conspiring with Blue Shield and with each other.



Inability to maintain an antitrust suit against an insurance company for its activities constituting the business of insurance, due to the insurer's jurisdictional immunity for such activities, does not prevent maintenance of an antitrust action against a non-insurance company co-conspirator which does not, by definition, fall within the ambit of the McCarran Act.

## ARGUMENT

### I.

### PETITIONERS ACTIVITIES IN COMBINING AND CONSPIRING TO FIX THE RETAIL SALES PRICES OF PHARMACEUTICALS, IN CONSPIRING TO EFFECT A BOYCOTT OF PHARMACY OWNERS WHO REFUSE TO FIX PRICES, AND IN CONSPIRING TO FORECLOSE PHARMACY OWNERS WHO REFUSE TO FIX PRICES FROM A SUBSTANTIAL PORTION OF THE MARKET DO NOT CONSTITUTE THE "BUSINESS OF INSURANCE" AND ARE NOT EXEMPTED FROM THE FEDERAL ANTITRUST LAWS BY THE McCARRAN-FERGUSON ACT.

#### A. The McCarran Act's Limited Immunity Only Applies To Activities That Constitute The "Business Of Insurance."

An appreciation of the McCarran Act's limited scope and applicability is essential a correct characterization of Petitioners' activities. The District Court's holding that the McCarran Act exempts Petitioners' challenged activities from antitrust scrutiny expands the Act's coverage to immunize from antitrust scrutiny virtually all activities of insurance companies and of those entities with which they contract. The Fifth Circuit refused to allow the expansion of the Act that the District Court permitted.

Section 2(b) of the McCarran Act provides as follows:

> No Act of Congress shall be construed to invalidate, impair or supersede any law enacted by any State for the purpose of regulating the *business of insurance . . . unless such Act specifically relates to the business of insurance*: *Provided, That* . . . the Sherman act, . . . the Clayton Act, and the Federal Trade Commission Act, as amended, shall be applicable to the *business of insurance* to the extent that *such business* is not regulated by State law. 15 U.S.C. § 1012 (b) (1970) [emphasis added].

The Act immunizes insurance companies from scrutiny under the federal antitrust laws only with respect to activities that constitute the "business of insurance," and only to the extent such activities are "regulated by State law".

A three step analysis is necessary to determine whether an insurance company's challenged activities fall within the Act's exemption. *See, e.g., Battle v. Liberty National Life Ins. Co.*, 492 F.2d 39, 49 (5th Cir. 1974), *cert. den.*, 419 U.S. 1110 (1975); *Travelers Ins. Co. v. Blue Cross*, 481 F.2d 80, 82 (3d Cir.), *cert. den.*, 414 U.S. 1093 (1973). First, the Court must determine whether the *challenged activities* constitute the "business of insurance". Second, it must determine whether the activities in question are regulated by State law. Third, the Court must determine the presence or absence of boycott, coercion, or intimidation.[13] *See*, 15 U.S.C. § 1013(b) (1970).

These three inquiries are independent of one another. A negative finding for the first question obviates the necessity

[13] Since the Fifth Circuit determined that Petitioners' challenged activities do not constitute the business of insurance, it did not need to reach the second and third steps of the analysis.



for a determination with respect to the second and third questions, and precludes application of the McCarran Act. *See, e.g., S.E.C. v. National Securities, Inc.*, 393 U.S. 453 (1969); *S.E.C. v. Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959); *American General Ins. Co. v. FTC*, 359 F. Supp. 887 (S.D. Tex. 1974), *aff'd*, 496 F.2d 197 (5th Cir. 1974). If the challenged activities do not constitute the "business of insurance", the McCarran Act is inapplicable despite the existence of State legislation proscribing or otherwise regulating them. As one Court recently noted,

> "Even though the Commonwealth [Virginia] may have legislation similar to the Sherman Act and the Clayton Act, the McCarran-Ferguson Act does not oust the Court of jurisdiction unless the activities complained of, though prohibited by State legislation, are . . . a part of the "business of insurance" as defined in *National Securities." American Family Life Assurance Co. v. Planned Marketing Associates, Inc.*, 389 F. Supp. 1141 (E.D. Va. 1974).

*Accord, e.g., S.E.C. v. National Securities, Inc.*, 393 U.S. 453 (1969) (Court held that despite existence of an Arizona statute which regulated the challenged activity, the McCarran Act was nevertheless inapplicable due to the activity's not being the "business of insurance"); *S.E.C. v. Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959) (holding that variable annuity contracts are not a part of the business of insurance despite the fact that District of Columbia and some states regulated them as a part of the business of insurance); *Center Ins. Agency v. Byers*, 1976-1 Trade Cases ¶ 60,940, at 69,122, 69,123 n.2 (N.D. Ill. June 10, 1976) (denying application of the McCarran Act despite the fact that the challenged acts were regulated by all states with which they came into contact).

Thus, a determination of what constitutes the "business of insurance" is of central importance to the act's application. Congress did not define the scope of "business of insurance" as used in the McCarran Act, and its has been necessary for the courts to determine which of the insurance companies' challenged activities the phrase encompasses. *S.E.C. v. National Securities, Inc.*, 393 U.S. 453 (1969).

In determining whether a challenged activity constitutes the "business of insurance", federal courts must remember that the McCarran act operates in derogation of the antitrust laws and is to be strictly construed. Very recently, the Court emphasized the continued viability of this principle by warning that the various statutes which, like the McCarran Act, constitute exceptions to application of the antitrust laws "are to be construed strictly". *Abbott Labs v. Portland Retail Druggists, Ass'n, Inc.*, 425 U.S. 1, (1976) (strictly construing the Nonprofit Institutions Act exception to the Robinson-Patman Act). *Accord, e.g., FMC v. Seatrain Lines, Inc.* 411 U.S. 726, 733 (1973); *Perkins v. Standard Oil Co.*, 395 U.S. 642, 646-47 (1969). The Court has served notice that the various antitrust statutes are remedial in nature and are to be liberally applied. Laxity in finding exemptions from the antitrust laws has been rebuked with the observation that "our cases have repeatedly established . . . a *heavy presumption against* implicit [antitrust] exemptions." *Abbott Labs v. Portland Retail Druggists Ass'n., Inc.*, 425 U.S. 1, (1976) (brackets in original, emphasis added), *quoting Goldfarb v. Virginia State Bar*, 421 U.S. 773, 787 (1975).

The McCarran Act's legislative history demonstrates that Congress did not intend to create an expansive exception to the antitrust laws. The Act was to be limited in scope and strictly construed.



> It is not the intention of Congress in the enactment of this legislation to clothe the States with any power to regulate or tax the business of insurance beyond that which they had been held to possess prior to the decision of the United States Supreme Court in the Southeastern Underwriters Association case. . . . In other words, we give to the States no more powers than those they previously had, and we take none from them. 91 CONG. REC. 1442 (1945) (remarks of Senator McCarran).

*Accord, State Bd. of Ins. v. Todd Shipyards Corp.*, 370 U.S. 403 (1962). Members of Congress expressed fears that the limited exception might be perverted to deprive non-insurance businesses of the protections afforded by the federal antitrust laws, and were assured by the draftsmen that the Act was to be limited in scope.

> [Senator Pepper] Mr. President, does that not necessarily mean that we would give to the several State legislatures power, the character and outlines of which we do not define, to determine whether a Federal law [the Sherman Act] enacted for the protection of all business and against all kinds of monopolies and restraints of trade shall be effective in the American Union?
>
> [Senator McCarran] The bill does not go that far. 91 CONG. REC. 1443 (1945) (Remarks of Senators Pepper and McCarran).

The bill was an attempt to vest the States with power to regulate and tax the "business of insurance" — and only such power.

In construing the scope of the phrase "business of insurance", as used in the McCarran Act, the Supreme Court

has given application to these principles of strict construction and has emphasized the Act's limited scope. It has warned that merely because challenged conduct has been engaged in by an insurance company does not dictate its characterization as the "business of insurance."

> The statute did not purport to make the States supreme in regulating all the activities of insurance *companies;* its language refers not to the persons or companies who are subject to state regulation, but to laws "regulating the *business* of insurance." Insurance companies may do many things which are subject to paramount federal regulations; only when they are engaged in the "business of insurance" does the statue apply." *S.E.C. vs. National Securities, Inc.* 393 U.S. 453, 459-60 (1969) [emphasis in original].

Clearly, the Court wished to emphasize that a defendant's identity as an insurance company does not *ipso facto* clothe it with federal antitrust immunity with respect to all its activities.

The question to be determined by the Court, then, is whether the particular activities complained of, *even though they may be actions taken by an insurance company*, are part of the "business of insurance" that Congress sought to remove from federal regulation. If the challenged activities do not constitute the business of insurance, and are thus without the Act's protective umbrella, the defendant is subject to the full force of the antitrust laws regardless of its identity as an insurance company. *See, e.g., DeVoto v. Pacific Fidelity Life Ins. Co.*, 516 F.2d 1, 3 (9th Cir. 1975) (expressly approving District Court's ruling that McCarran Act was inapplicable to an insurer's activity in conspiring with a mortgage banker to foreclose another insurer from a segment of California market for



mortgage protection insurance); *Allied Financial Services, Inc. v. Foremost Ins. Co.*, 418 F. Supp. 157 (D. Neb. 1976) (holding that insurer's interference with general agent's contractual relations only peripherally involved business of insurance and were not entitled to McCarran Act protection); *American Family Life Assurance Co. v. Planned Marketing Associates, Inc.*, 389 F. Supp. 1141 (E.D. Va. 1974) (holding McCarran Act inapplicable to insurance company's activity in inducing plaintiff's agents to cease selling plaintiff's insurance and, instead, to sell defendant's policies); *Hill v. National Auto Glass Co.* 293 F. Supp. 295 (N.D. Calif. 1968) (holding McCarran Act exemption inapplicable to the activity of Allstate Insurance Co. in securing for various glass dealers the sales and installation jobs required by Allstate's claimants).

In subtly arguing for a broad construction of the McCarran act, Petitioners avoid any mention of the Supreme Court's decision in *Abbott Labs.* Petitioners have purposely avoided mention of *Abbott Labs* and its warning that the various statutory exemptions from the antitrust laws are to be strictly construed because the McCarran act can be found applicable to the challenged conduct in this case only through the most expansive construction of the act imaginable. Petitioners would have this Court conclude that any conspiracy between an insurance company and a provider of benefits that increases the insurer's profits or reduces its costs is shielded from the proscriptions of the antitrust laws by the McCarran Act. Just as the Court in *Abbott Labs.* rejected several drug manufacturer's expansive reading of the Nonprofit Institutions Act exception to the Robinson-Patman Act, the Court should reject Petitioners' expansive reading of the McCarran Act.

### B. Activities That Primarily Affect The Relationships Between Competing Providers Of Benefits Or Between Competing Providers of Benefits And Their Customers, As Do The Challenged Activities Of Petitioners, Are Not The Business Of Insurance.

#### 1. The McCarran Act's Focus Is on the Relationship Between The Insurer And The Insured.

In *S.E.C. v. National Securities, Inc.*, 393 U.S. 453 (1969), the Court articulated guidelines for ascertaining which activities of an insurance company constitute the "business of insurance" within the McCarran Act. It noted as follows:

> The relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation and enforcement — these were the core of the "business of insurance". Undoubtedly, other activities of insurance companies relate so closely to their status as reliable insurers that they too must be placed in the same class. But whatever the exact scope of the statutory term, it is clear where the focus was — it was on the relationship between the insurance company and the policyholder. *Id.* at 459-60.

The Court applied this standard in *National Securities, Inc.* to deny that the merger of two insurance companies constituted the business of insurance, and thereby further refined the test. It is stressed that central to the determination is the question how closely the challenged activity concerns the relationship between the insurance company and the policyholder. If the connection between the challenged activity and this relationship it attenuated, and the insurer has gone beyond its function of underwriting a risk for a premium, the activity will not be considered to constitute the business of insurance. *Accord, e.g., Allied Financial Services, Inc. v. Foremost Ins. Co.*, 418 F. Supp. 157, 161



(D. Neb. 1976) (holding McCarran Act inapplicable where insurer's interference with general agent's contractual relations primarily related to agency agreement and not policyholders); *American Family Life Assurance Co. v. Planned Marketing Associates, Inc.*, 389 F. Supp 1141, 1147 (E.D. Va. 1974) (holding McCarran Act inapplicable where the relationship affected by the challenged activity was primarily that between two insurers and not that between the insurers and their policyholders). The mere fact that the challenged activity may have some slight effect on the insurance company's reliability, its solvency, or its ratemaking is insufficient. Virtually every business activity by an insurer will have some effect, however slight, on these parameters. It is the relationship primarily affected by the challenged activity that is crucial.

In *National Securities, Inc.*, the Court held that the activity of two insurance companies in merging did not constitute the business of insurance, despite the fact that the transaction undoubtedly affected policyholders in terms of the security of their insurance contracts and the reliability of their insurers. Central to the Court's decision that the insurers' merger activity was without McCarran Act protection, despite the possible effects on policyholders, was its determination that the "business of insurance" pertained to those activities *peculiar* to the insurance industry. Business activities of insurance companies not peculiar to their function as insurers, even though they were bound to affect policyholders, were held by the Court to be outside the McCarran Act and subject to federal regulatory laws. *Accord, e.g., Center Ins. Agency, Inc. vs. Byers*, 1976-1 Trade Cases ¶60,940, at 69,122 (N.D. Ill. June 10, 1976); *American Family Life Assurance co. vs. Planned Marketing Associates, Inc.*, 389 F. Supp. 1141 (E.D. Va. 1974); *Ameri-*

*can General Ins. Co. vs. FTC*, 359 F. Supp. 887 (S.D. Tex. 1973), *aff'd*, 496 F.2d 197 (5th Cir. 1974).

**2. Thie Challenged Activities Primarily Relate The Relationships Between Competing Pharmacies And To The Relationships Between Competing Pharmacies And Their Customers.**

The activities challenged herein, like that before the Court in *National Securities, Inc.*, relate primarily to relationships other than that between the insurer and its policyholders and are not peculiar to the insurance industry. Any effects on the relationship between Blue Shield and its policyholders are merely peripheral and are secondary to the effects on the relationships between competing pharmacies and between such pharmacies and their customers. The policy here does not include the fixing of the pharmacist's retail price as a "benefit" to the insured.

The relationship between competing pharmacies is affected because the fixing of retail sales prices eliminates competition between pharmacies in pricing and in the provision of the customer services. As the number of individuals covered by Blue Shield's prescription drug insurance increases, which the record shows it has been doing at a dramatic rate, the elimination of competition between pharmacies will become all the more complete. The large pharmacy chains who sell many items in addition to pharmaceuticals, whose customer services are limited, and who can afford to operate under the agreement, will be enabled to eliminate the small independent neighborhood pharmacies whose existence depends primarily on profits derived from the sale of prescription drugs.

That the relationship primarily affected by the price fixing agreement and the coercion is that between competing



pharmacies is graphically illustrated by examining the effects that the challenged activities would have on other sectors of our private economy. If the activities as challenged herein are held to constitute the business of insurance, then automobile insurers will be able to utilize Participating Repair Shop Agreements and Coercion to set prices for parts and labor in the automobile repair industry. Since third party payments cover a large percentage of the automobile repair work currently performed, the insurance companies would be able to combine and conspire with the large repair shops to set prices for parts and labor. The small independents would be squeezed out of business.

The coverage provided by insurance companies in our modern society is so pervasive that examples of "Participating Agreements" between insurers and the providers of services would be limited only by the bounds of human ingenuity. Companies that write fire insurance would be able to execute "Participating Construction Company Agreements" and thereby combine and conspire with large construction companies to set the prices for the repair and rebuilding of homes or buildings damaged by fire. They would also be able to execute Participating Agreements with large department stores and thereby endeavor to set prices at which insureds would replace televisions, stereos, furniture, clothing and other articles destroyed by fire. Hardly, a sector of our economy would be free from the price fixing activities of insurance companies if the activities as challenged herein are immune from the federal antitrust laws. Insurers and the large "providers" would be given *carte blanche* to determine the prices to be charged in each industry that happens to sell goods which are purchased with the proceeds of insurance policies. These entities would be free to determine whether and what forms of competition

are to be allowed, as well as which competitors would be allowed to exist.

Indeed, if the challenged activities are allowed under the guise that they constitute the business of insurance, they could be utilized to eliminate competition among many other entities in addition to those providing goods and services directly to the insurer's policyholders. For example, if Blue Shield is allowed to combine and conspire with pharmacies to fix the retail sales prices of pharmaceuticals, nothing prevents Blue Shield's combining and conspiring with pharmaceutical manufacturers to fix the wholesale prices of pharmaceuticals. Blue Shield could enter into Participating Drug Manufacturer Agreements with various manufacturers of penicillin, which would require the manufacturers to sell penicillin to Blue Shield's Participating Pharmacies at or below the price stipulated in the agreement. If a small manufacturer refused to sign the price fixing agreement, Blue Shield could exert pressure by refusing to provide its policyholders with coverage for that manufacturer's brand of penicillin, or by providing markedly reduced benefits when that brand was purchased. If the small manufacturer depended heavily on sales of antibiotics to stay in business, and if the price agreed on by Blue Shield and the large, diversified manufacturers was too low for the small manufacturer to make an adequate return, it would be pushed out of business. Certainly Congress never intended that the McCarran act be utilized to shield such activity from application of the federal regulatory laws. Although Congress, in enacting the Act, wished to authorize state-supervised rate setting, it was as opposed to private price-fixing as ever and did not intend that such activity be shielded from federal scrutiny by the McCarran Act. *See*, in particular, comments by Senator O'Mahoney, a co-



sponsor of the bill in 91 CONG. REC. 1480, 1483, 1485-86 (1945).

### C. Insurance "Jargon" and "Catch" Phrases" Cannot Be A Substitute For Careful Analysis When A Court Decides Whether Challenged Activities Constitute The Business Of Insurance.

When the Court articulated guidelines for determining which activities of insurers constitute "the business of insurance," it emphasized that the term's focus was on the "relationship between the insurance company and the policyholder." *See S.E.C. vs. National Securities, Inc.*, 393 U. S. 453, 459-60 (1969). Additionally, the Court stated that at the core of the "business of insurance" was "the type of policy which could be issued, its reliability, interpretation and enforcement." *Id.* Other activities of insurance companies were said to be included provided "they relate so closely to their status as reliable insurers" as to require inclusion. *Id.*

These standards articulated by the Court can serve as a basis for analysis, as the Court undoubtedly intended, or they can be utilized as catch phrases to describe virtually any activity undertaken by an insurer. Unfortunately, an insurance "jargon" has arisen in McCarran Act cases, and defendants have converted the Court's guidelines to mechanical word formulae, which routinely are utilized to describe their challenged activities.

Petitioners do not discuss the activities challenged by Respondents. Rather, they choose to talk about innocuous contracts "between an insurer and a health care provider *to furnish benefits owed to policyholders under the insurer's health care policies.*" (Brief for Petitioners at 16) (emphasis added). They label these innocuous contracts as "provider

agreements," state that they have been around since at least the 1930's, and allege that The Pharmacy Agreement is just another old and familiar "provider agreement." Brief for Petitioners at 20-27. Then Petitioners proceed to utilize the Court's guidelines as a form of insurance "jargon" to describe The Pharmacy Agreement. *See* Brief for Petitioners at 20-31.

A close perusal of the Prescription Drug Insurance Policy (McDonald Depo. Exhibits 37 and 39, App. 303a-318a) demonstrates that the fixing of retail sales prices for pharmaceuticals and the coercion of pharmacies to fix their prices *are not* "benefits owed to policyholders under the insurer's health care policies." Indeed, Blue Shield's sole obligation is to see that *the insured* receives prescription drugs and "*shall be required to pay no more* than the drug deductible for each of such covered drugs." The policy describes providers as participating or non participating based only on whether they have agreed to furnish covered drugs. Price is not mentioned. It is not relevant to the policyholder that Blue Shield conspires with pharmacies to fix retail sales prices in the pharmacy industry.

As Blue Shield's Assistant Vice-President in charge of enrolling "Participating Pharmacies" testified, the Pharmacy Contract merely is a contract between Blue Shield and the pharmacy, which the policyholder never sees (Johnson Depo. at 34, App. 151a). The policyholder is obligated to pay a participating pharmacy $2.00 for his prescription regardless of the presence or absence of price fixing. The conspiracy to fix prices is merely a profit-maximizing endeavor for Blue Shield's benefit, as the merger activity of two insurance companies in *S.E.C. v. National Securities, Inc.*, 393 U. S. 453 (1969), was an activity for the financial



benefit of the two insurers, which activity was held to be peripheral to the business of insurance.

Blue Shield is no more obligated to its policyholders to fix the retail sales prices of pharmaceuticals than an automobile insurer is obligated to its insureds having $100 deductible policies to fix the prices charged by body shops for parts and labor. Just as the automobile insurer is obligated to pay the retail cost of repair, whatever it might be, over and above the applicable policy deductible, Blue Shield is obligated to pay the retail cost of prescription drugs over and above the $2.00 drug deductible. There is no obligation to fix prices! As the Prescription Drug Insurance Policy provides, "[p]ayment of benefits by Blue Shield of Texas to the provider or the employee . . . shall constitute full discharge of all responsibility of Blue Shield of Texas to the employees." (Article IIIC of McDonald Depo. Exhibit 39, App. 316a).

Further proof that the fixing of prices is not a "benefit" owed to policyholders" is afforded by Article VIB of the Prescription Drug Insurance Policy, which provides as follows:

> Blue Shield shall not be liable for any claim or demand for injuries or damages arising out of or in connection with the manufacturing, compounding, dispensing or use of any Prescription Legend Drug or insulin, whether or not covered under this supplement. (McDonald Depo. Exhibit 39, App. 318a)

By virtue of this paragraph, Blue Shield services notice that the sale of pharmaceuticals is a transaction between the pharmacy and the policyholders with respect to which Blue Shield assumes no responsibility *or obligation* other than that of underwriting the sale.

Petitioners make the ingenious argument that The Pharmacy Agreement merely allows Blue Shield to furnish benefits *owed* to policyholders under the insurer's health care policies, and nothing more, because "Blue Shield has agreed to furnish policy benefits to its insureds through providers of prescription drugs" and "the only way such benefits can be guaranteed is through contractual arrangements with pharmacies." (Brief for Petitioners at 13). Further, "[t]he failure to provide Participating Pharmacies which permit the insured to obtain drugs on the terms and for the amounts stated in the policies would constitute a breach of the contract of insurance." (Brief for Petitioners at 13-14). This argument is a red herring.

Respondents are not attacking the mere fact that Blue Shield has entered into agreements with pharmacies, which agreements require the pharmacies to dispense pharmaceuticals to Blue Shield's policyholders and to look to the policyholders for direct payment of only a $2.00 drug deductible. If this were all that the Pharmacy Agreements provided, Respondents would have no complaint concerning The Pharmacy Agreements; and it would be true that The Pharmacy Agreements merely required the performance of obligations owed to the insured and nothing more. However, The Pharmacy Agreements do more than merely obligate the Participating Pharmacies to dispense pharmaceuticals to Blue Shield's insureds in return for a direct payment by the insured of the $2.00 drug deductible. The Pharmacy Agreements go beyond this innocuous function and serve as a vehicle by which competing pharmacies conspire and agree concerning the *total price* that they will charge for dispensing pharmaceuticals to Blue Shield's policyholders. By virtue of The Pharmacy Agreements' price



fixing provision, Blue Shield and Petitioner Pharmacy chains are conspiring to eliminate price competition in the retail pharmaceutical industry. Contrary to their claims, it cannot be said that the terms and provisions of the prescription drug insurance policies expressly contemplate the execution of such agreements. The Prescription Drug Insurance Policy does not mention execution of agreements that serve to fix retail prices in the pharmaceutical industry.

Contrary to the impression that Blue Shield desires to create, this Court's striking down the price fixing aspects of The Pharmacy Agreements would not interfere with or preclude Blue Shield's providing its policyholders with Participating Pharmacies. Blue Shield would in no way be precluded from contracting with pharmacies to dispense pharmaceuticals to its policyholders in return for the policyholders' direct payment to the pharmacies of the $2.00 drug deductible. It is the latter agreement that is expressly contemplated by the Prescription Drug Insurance Policy, not an agreement that seeks to fix prices in the pharmaceutical industry. As has been discussed, the decision to embody the price fixing conspiracy within The Pharmacy Agreement was merely part of an elaborate scheme to shield such activity from antitrust scrutiny by virtue of the McCarran Act. See Johnson Depo. Exhibit 32, App. 276a-277a, Add. 1). The Court must not be misled by Blue Shield's scheme.

The Pharmacy Agreement is not just another old and familiar "provider agreement." Each Justice of this Court need only analyze his own experience with insurance policies down through the years to see the fallacy of the story Petitioners have woven. Can a single Justice recall having been told the following by his insurer upon the occurrence of an auto accident: "You need only pay the $100 deductible if you take the car to a "participating repair shop," but you

must pay 25% of a reasonable charge for repairs, as determined by us, in addition to the $100 deductible if you take the car to a "non-participating repair shop"?

Petitioners' efforts to convince the Court that their challenged activities have been around since the depression are internally inconsistent. On page 6 of Petitioners' brief, Blue Shield argues that its challenged activities had their roots in the 1967 collective bargaining agreement between the United Auto Workers, Ford, General Motors, and Chrysler. Indeed, the May 28, 1968, letter to Blue Shield's president, Johnson Depo. Exhibit 32 (App. 276a-277a) (Add. 1) marks the inception of Petitioners' challenged activities. In that letter, an officer of the National Association of Blue Shield plans communicated his "germ of an idea" for pursuing anticompetitive activities in the retail pharmaceutical industry in a manner that would "strengthen your [Blue Shield's] basis on antitrust." *Id.* What was being contemplated in the letter, and what arose from the letter, was not just another old and familiar "provider agreement."

At least the National Association of Insurance Commissioners (NAIC) has admitted in its amicus curiae brief that Petitioners' challenged activities as implemented by The Pharmacy Agreement are not holdovers from the great depression, but are a new "experiment" to "contain costs." *See* Amicus Curiae Brief of the National Association of Insurance Commissioners (NAIC Brief) at 37-43.

Petitioners' activities may indeed constitute an "experiment" for insurers, but the Court will recognize them, absent their "provider agreement" camouflage, as time-worn abuses of our free market economy practiced by entities with market power. A close scrutiny of this "experiment" in "cost containment" — a scrutiny that focuses on *whose* costs



are being "contained" and *why* — illustrates that the activities challenged by Respondents are peripheral to the business of insurance and, as far as Blue Shield is concerned, merely constitute an effort by Blue Shield to increase its profits at the expense of competition in another, non-insurance industry.

### D. The "Experiment" In "Cost Containment" Is Not A Part Of The Business of Insurance.

#### 1. It Is Not The Office Of The Insurance Industry To Set The Prices In The Various Sectors Of Our Economy So That Insurers Will Enjoy An Added Measure Of Control Over The Magnitude Of Individual Claims.

Petitioners cite *S.E.C. v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 73 (1959), for the proposition that the "earmark" of insurance is the 'underwriting of risks' in exchange for a premium." (Brief for Petitioners at 20). With respect to the Prescription Drug Insurance Policy, Petitioners allege the "risk" insured against is the following:

> the possibility that, during the term of the policy, *the insured may suffer a financial loss arising from the purchase of prescription drugs*, or that he may be financially unable to purchase such drugs. *Id.* (emphasis added).

Petitioners then claim that Blue Shield "assumes this risk," which, after all, is the essential function of an insurer — to assume all or a portion of a specified risk in return for payment of a premium.

Blue Shield claims to be "assuming the risk" by contracting with "Participating Pharmacies." *Id.* Herein lies the heart of the great fallacy Petitioners are trying to propagate. By conspiring with the Petitioner pharmacy chains to fix the retail sales prices for pharmaceuticals, and by pursuing

a course of conduct calculated to coerce independent pharmacies to agree on retail prices, Blue Shield is seeking to rid itself of the risk it would shoulder if it were truly functioning as an insurer engaged in the business of insurance — not assume the risk. Blue Shield is seeking to shift the expense and burden of the risk to the retail pharmaceutical industry. In pursuing these activities, Blue Shield is acting outside the business of insurance. A step by step analysis will illustrate this point.

An individual faces the possibility that he will need prescription drugs, but does not know how often he will need them or the price he will pay. He purchases insurance, prescription drug insurance, which basically provides that in exchange for the premium and after payment by him of a deductible each time, the balance of the cost will be paid by an insurer. Blue Shield, however, in limiting the pharmacist to the receipt of the deductible from the insured and the acquisition cost from Blue Shield, has taken a substantial portion of the risk it insures against and shifted it to the retail pharmacies which are *not* in the business of underwriting Blue Shield's risk. It is not necessary that Blue Shield fix prices in the retail pharmacy industry to have the control over its claims as it would have this Court believe is all that it is trying to do. Blue Shield is not the guardian of its customers' financial wellbeing, nor are the state insurance commissioners the guardian of the public pocket book in all respects. Indeed, they are insurance commissioners, not pharmacy commissioners, drug commissioners, automobile commissioners, home repair commissioners, furniture commissioners, or clothing commissioners. Their function basically is to see that benefits are fair and reasonable for the premium paid, and that companies have sufficient reserves to meet their obligations to their policy holders. Yet Blue Shield and the National Association of Insurance Commissioners claim that they are the only proper guardians of the prices charged in the various provider industries. They seek to "contain costs" at the expense of competition and use this case in actuality to attempt to take a limited exemption to the anti-trust laws, the McCarran Act, and expand it to cover virtually every contract that an insurance company may enter into with a provider of benefits.



They purport to justify their price fixing activities by use of the term "cost containment." However, every business, not just insurance companies, is concerned with containing their costs. Congress has determined that costs can best be contained by free and unfettered competition, and this strong, national policy has been evidenced in the federal anti-trust laws. This Court should not take the various competitive sectors of our economy and subject them to regulation by the state insurance commissioners and the insurers, but that is exactly what Petitioners and their amici ask this court to do in this case. Almost every other form of insurance allows the free market forces of competition to operate. The insurers may limit their risk in many ways in their contract with the insured — by limiting the number of claims per period of time, by limiting the dollar amount of benefits per claim, and by use of deductibles. Yet here what is attempted to be immunized from the federal anti-trust laws is an attempt to fix prices in non-insurance industries. If containing costs is the test, then the next step will be that insurance companies will "contain" providers' costs that are purely administrative and operational. Further, if this court reverses the Fifth Circuit's decision, insurers will be given *carte blanche* to violate the federal anti-trust laws with impunity. Indeed, if there were ever a case which shows the wisdom of Congress in passing the Sherman Act, and providing for the private federal anti-trust action, this case is it.

When it first contemplated fixing pharmacists' prices, Blue Shield knew it was invading a non-insurance sector of the economy. This is illustrated in the previously mentioned correspondence between the president of Blue Shield of Texas and an official of the National Association of Blue Shield Plans concerning the preparation of what was to become Blue Shield's Pharmacy Agreement. *See* Johnson Depo. Exhibit 32 (App. 276a-277a) (Add. 1). The letter expressly contemplates an agreement between Blue Shield and pharmacies, the effect of which would be to fix the latter's prices. It suggests that the price fixing agreement with pharmacies be camouflaged under the guise it is a "mass accounting agreement" and indicates Blue Shield might avoid antitrust scrutiny by drafting the price fixing agreement in such manner as to create the illusion it is part of the business of insurance regulated by the State Board of Insurance.

> "I think it would be best to draft the contract so that the Insurance Board would require filing of the mass accounting agreement [Pharmacy Agreement] to strengthen your base on anti-trust. Drafting problems will get sticky here, but let's pass on that for now."

(Johnson Dep. Exhibit 32, App. 277a, Add. 1). Despite the sugar-coating contemplated by the correspondents, the basic price-fixing function is clearly articulated.

> The mass accounting agreement [Pharmacy Agreement] probably should have self-serving whereas clauses emphasizing Blue Shield's intent to offer coverage, desire to relate payments to providers for these services, and the need to simplify administration and accounting in the public interest. The basic agreement would be that the accounting basis of indemnification under the facility of payment clause of the subscriber contract, for Blue Shield subscribers for



> services rendered by the pharmacy, would be acquisition cost plus dispensing fee in the aggregate for all services within a reporting period and that the pharmacy would make no charge to the subscriber in excess of the deductible."

*Id.* The correspondence leaves no doubt that the price-fixing and discrimination in benefits actually are not intended by the parties to relate to any "simplification in administration and accounting." They are intended to have their natural and probable effect — the fixing of prices in the pharmacy industry.

> "Tom, there are a lot of holes in this, but the alternative is paying usual and customary — *and praying*." *Id.* (emphasis added).

The alternatives to price fixing are Blue Shield's paying the individual pharmacists' usual and customary charge, as does the individual who shops on the open market without insurance, or Blue Shield's paying some fixed percentage or maximum dollar amount of the individual pharmacist's usual and customary charge, with the subscriber being responsible for the balance of such charge. These alternatives are pursued by traditional insurers, who engage in the business of insurance without conspiring to fix prices.

By fixing prices, Blue Shield has gone beyond the business of providing prescription drug insurance and has encroached on the business of selling prescription pharmaceuticals. It is not a part of the business of insurance for an insurer to use its market power to see that its insureds obtain the goods and services contemplated by the insurance policy on a "cost-plus" basis or any other basis that might be more economical for the insurer than the insured's retail purchase of such products on the open market. It is the

business of insurance for an insurer to underwrite risks, not to wield its massive economic power against other industries in an effort to control the retail prices charged by those industries.

By conspiring with pharmacies to fix retail sales prices in the pharmacy industry, Blue Shield has engaged in activities totally alien to the insurer-policyholder relationship, which is the focus of the McCarran Act. Such activity *clearly is not* the business of insurance! Its focus is not the insurer-policyholder relationship and it certainly is not peculiar to the insurance industry. Blue Shield suddenly argues that the "reliability" of its prescription drug insurance policies "is dependent upon Blue Shield's contracting with Participating Pharmacies for the benefit of its insureds." Brief for Petitioners at 27. To the extent that Blue Shield's "reliability" argument includes the price fixing aspects of The Pharmacy Agreement and Blue Shield's use of coercion to fix pharmaceutical prices generally, it is nothing more than an argument that any activity which will increase an insurer's profits affects the "reliability" of its insurance policies. Obviously, any activity that will increase an insurer's profit margin is calculated to make it and its policies more reliable in the sense that the company is less likely to go bankrupt. However, the Supreme Court has served notice that the mere fact that an activity will serve to make an insurer more financially stable, and hence more "reliable", does not dictate the activity's classification as part of the business of insurance. *See S.E.C. v. National Securities, Inc.*, 393 U.S. 453 (1969). In *National Securities, Inc.*, the Supreme Court held that the activity of insurance companies in merging did not constitute the business of insurance, despite the fact that the transaction undoubtedly directly affected the financial stability of the two companies,



which in turn affected policyholders in terms of the security of their insurance contracts and the reliability of their insurers. If activities' financial effects on insurance companies were utilized as the test whether the activities related directly to the insurers' status as reliable insurers, and thus were within the McCarran Act's protective scope, the Act would serve to shield virtually any activity of an insurer from antitrust scrutiny. *National Securities, Inc.* rejected this notion.

Petitioners endeavor to justify their "cost containment" by arguing that Blue Shield faces "indeterminate liability" under its prescription drug insurance policies. (Brief for Petitioners at 23). They explain further:

> Because illnesses vary in frequency, duration and severity, and because the prices of prescription drugs are subject to rapid inflation, no one knows in advance of the insured's illness what monetary obligation Blue Shield will be required to bear to satisfy his or her claim. *Id.*

This statement does nothing more than describe the risk that the individual contracts to shift to the insurer when he buys prescription drug insurance. Blue Shield's lack of desire to shoulder the risk does not convert to the "business of insurance" its efforts to shift the risk to the retail pharmaceutical industry. Congress did not contemplate that the McCarran Act be utilized to insulate such activities by insurers from the federal antitrust laws. As one Court recently observed,

> The roll of insurance in our complex commercial society is pervasive. Insurance companies with their policies, their agents and their customers touch and concern all commercial activity. The McCarran-Ferguson Act did not purport to make state legislation

> supreme in regulating all the activities of insurance *companies.* It does allow the states to regulate the *business* of insurance . . . but such business if not the subjct of this litigation." *DeVoto v. Pacific Fidelity Life Ins. Co.*, 354 F. Supp. 874 (N.D. Calif. 1973) [emphasis in original], *aff'd as to holding on McCarran Act, rev'd and remanded on other grounds*, 516 F.2d 1, 3 (9th Cir. 1975).

Such business likewise is not the subject of the present litigation!

**2. The Supposed Public and Governmental Mandate To "Contain" Health Care Costs Does Not Make Petitioners' Challenged Activities The Business of Insurance.**

Petitioners and especially their amici devote much attention to a discussion of spiralling HEALTH CARE COSTS. Time and again they refer to a huge escalation in HEALTH CARE COSTS and to Blue Shield's obligation to contain such costs. They even cite some statistics to show a dramatic increase in HEALTH CARE COSTS. But what about PRESCRIPTION PHARMACEUTICAL COSTS? Why have Petitioners and their amici avoided giving statistics for increases in PRESCRIPTION PHARMACEUTICAL COSTS when such statistics are readily available in the same sources that were consulted for HEALTH CARE COSTS, and when the costs Petitioners allegedly seek to "contain" herein are those for prescription pharmaceuticals?

Petitioners and their amici have carefully avoided a discussion of the rise in prescription pharmaceutical costs because they wish to give Petitioners' challenged activities a social credibility that does not really exist. They wish to establish the impression that there is a public and governmental mandate calling for Petitioners' price fixing activities.



Contrary to the impression Petitioners and their amici try to create, statistics compiled by the U. S. Department of Labor demonstrate that the retail prices of prescription pharmaceuticals have been dramatic for their small increases over the years — *not* for their rapid escalation as Petitioners and their amici infer by citing "health care" statistics.

In the period 1967-February, 1978, the prices for prescription pharmaceuticals increased *only 28.5%*, while the prices of amici Motor Vehicle Manufacturers' new cars increased 51.1% — almost twice as much! U. S. DEP'T. OF LABOR, BUREAU OF LABOR STATISTICS, CONSUMER PRICE INDEX DETAILED REPORT FEBRUARY, 1978 (CONSUMER PRICE INDEX) at 22-23 (1978). The small increase in prices for prescription pharmaceuticals is even more dramatic when one notes that over the same period, the average increase in prices for all items was 88.4% — slightly more than three times as much![14] CONSUMER PRICE INDEX at 13. In discussing "the rapidly escalating costs of health care," amici United Auto Workers not only fail to cite statistics for prescription pharmaceuticals, but fail to point out that over the period 1967-February, 1978, the salaries of individuals employed in the manufacture of transportation equipment increased 99.5% — almost four times as much as the increase in costs of prescription pharmaceuticals! U. S. DEP'T. OF LABOR, BUREAU OF LABOR STATISTICS, EMPLOYMENT AND EARNINGS MAY, 1978 at 99 (1978).

Where is the "crisis" in prescription pharmaceutical costs? There is much more of a "crisis" in the costs of automobiles

[14] At least it safely can be assumed that Blue Shield will not now make an about face and endeavor to take credit for the pharmaceutical industry's admirable performance in the area of price increases. The Blue Shield Association has alleged that Blue Shield plans underwrite only 2% of total retail drug sales. Amicus Curiae Brief of The Blue Shield Association at 33.

and the salaries of auto workers than there is in prescription pharmaceutical costs. The rising costs of hospital rooms in America, which is the basis for the statistics cited by Petitioners and their amici, cannot justify insurers' undertaking private regulation of other industries that happen to sell goods or services purchased in whole or in part with the proceeds of insurance.

Petitioners claim that their challenged activities are being conducted in response "to the urgings of government officials, employers and labor unions." Brief for Petitioners at 23. There is no indication of "urgings by government officials." In alleging such "urgings", Petitioners and their amici omit discussion of congressional recommendations that run directly counter to Petitioners' challenged activities. One such recommendation is the following:

> That the fee paid to pharmacists be flexible and vary according to the individual pharmacists' cost of doing business, and that he be given additional sums for the extra services he provides to assure that he is adequately compensated for his services, and to encourage the expansion of improved services which will benefit the consumer. SUBCOMMITTEE ON ENVIRONMENTAL PROBLEMS AFFECTING SMALL BUSINESS OF THE PERMANENT SELECT COMMITTEE ON SMALL BUSINESS, PROBLEMS OF THIRD PARTY PREPAID PRESCRIPTION PROGRAMS, H. R. DOC. NO. 93-730, 93d Cong., 1st Sess. 17 (1973) (*Problems of Third Party Prepaid Prescription Programs*).

In arguing against the very activities Petitioners and their amici claim are being conducted with a public and governmental mandate, this Congressional report stressed the dangers of the activities.

> Demographically, union members tend to concentrate in specific sections of a city. Businesses serving these concentrated areas are basically service businesses which are dependent upon continued union member patronage. Nonparticipation by a pharmacist serving such areas would discourage union member patronage and result in financial failure. Yet, because of the inflexibility in the method of determining his fee, participation in third party programs may also result in financial failure. Herein lies the essence of the pharmacist's dilemma. *Problems of Third Party Prepaid Prescription Programs* at 6.



The Congressional Report expressed additional concern, "that fixed fees provide no incentive to pharmacists to improve the quality of their services, and, thereby, might discourage improvements which increase the quality of this Nation's health care systems." *Problems of Third Party Prepaid Prescription Programs* at 10. This Congressional Report did *not* recommend that insurers take steps to "contain" pharmacists' prices. Rather, it expressed a concern with insurers' activities and recommended that the Department of Justice do the following:

> Undertake an investigation of the concentration of certain insurance companies and plan administrators in the third party prepaid prescription program market to determine if there is real competition among these firms or if there has been a de facto division of the market by these competitors. *Problems of Third Party Prepaid Prescription Programs* at 17.

The report voiced a Congressional concern that "programs" such as that of Blue Shield pose a "threat . . . to the continued existence of the independent retail pharmacies." *Problems of Third Party Prepaid Prescription Programs* at 15. Perhaps most significant of all, the report suggests a Congressional belief that Blue Shield's challenged activities

are not a part of the business of insurance. The Department of Justice's inaction in dealing with these activities was rebuked as follows:

> [T]he subcommitte is of the opinion that the Department [of Justice] still fails to recognize the inequities faced by independent retail pharmacists as a result of these programs and has not yet taken a realistic view of the competitive factors which dictate their participation. Until this is done, the competitive position of the independent pharmacist will continue to diminish to the point where the continued existence of this vital sector of the economy is threatened. *Problems of Third Party Prepaid Prescription Programs* at 15.

By no stretch of the imagination can it be said that Congress considers Blue Shield's "cost containment" activities to be part of the business of insurance or that Congress urges such activities.

In their efforts to create the illusion of governmental support for their activities, Petitioners attribute to the Attorney General of Texas the assertion that " 'group health or group medical plans' with provider agreements of the type offered by Blue Shield 'came into vogue during the depression.' " (Brief for Petitioners at 21). Once again, Respondents caution the Court to review carefully the Attorney General's opinion to which Petitioners are referring. As was discussed at pages 29-32, *supra*, the provider agreement utilized by the corporation being studied by the Attorney General differs vastly from The Pharmacy Agreement being utilized by Blue Shield in conjunction with its other coercive activities. Additionally, Petitioners have perverted the Attorney General's statement, which was as follows:

> We can find no cases in this or other jurisdictions passing upon arrangements exactly the same as that herein involved. It resembles in some respects and is presumably based upon medical plans previously passed upon by the courts of certain other jurisdictions, primarily the group health or group medical plans which came into vogue during the depression. (App. 478a).



That Petitioners can derive their assertion from that statement actually made by the Attorney General is highly curious.

Even more incredible is Petitioners' assertion that at the time the McCarran Act was passed, "Congress was aware of the use in the Health insurance business of third-party provider agreements *similar to those in issue here*." Brief for Petitioners at 22. To support this proposition, Petitioners note that Attorney General Biddle testified during joint Congressional committee hearings that he interpreted the Court's opinion in *American Medical Association v. United States*, 317 U. S. 519 (1943), to hold that prepaid health care plans were the business of insurance. *Id.* Petitioners then claim that the *AMA* case "bears strong similarities to the instant case" and that in the *AMA* case, Group Health Association, Inc. "had entered into agreements with 'participating providers.' " *Id.* Evidently, this Court is supposed to conclude that the activities challenged herein parallel the agreements between Group Health Association, Inc. and its *employee* physicians in the *AMA* case, and that Congress considered the employment contracts in the *AMA* case to be a part of the "business of insurance." Neither of these concepts has any validity.

As the Court clearly stated in the *AMA* case, "Group Health *employed* physicians on *a full time salary basis* . . . ." 317 U. S. at 526 (emphasis added). Further, it noted that "the doctors having contracts with Group Health *were em-*

*ployees of that corporation.*" 317 U. S. at 535-36 (emphasis added). The activities being challenged were the defendants' efforts "to prevent anyone from taking employment under Group Health." 317 U. S. at 536. There is absolutely no correlation between the challenged activities herein and the *AMA case*, the employment contracts in the *AMA* case, or the challenged activities in the *AMA* case. Nor there any indication that Congress considered the employment contracts in the *AMA* case to be a part of the business of insurance. Indeed, the Texas Attorney General's opinion cited in several instances by Petitioners states that when a corporation pays doctors "a fixed annual compensation" to render medical services to the corporation's subscribers, "the business [is] . . . not . . . insurance in nature." App. 478a-479a. Texas would not consider the arrangement before the Court in the *AMA* case to be "the business of insurance."

The protestations by Petitioners and their amici that Petitioners' anticompetitive activities are being conducted with the knowledge, acquiescence, and urging of government officials and agencies should be familiar to the Court. Similar arguments have often been made by entities that have desired a license by the Court to violate the federal antitrust laws. Similar arguments were made by the defendants in *United States v. Socony-Vacuum Oil Co.*, 310 U. S. 150 (1940), who sought "to establish that the Petroleum Administration Board knew . . . [of their price fixing activities] and acquiesced in them." 310 U. S. at 207. The Court rejected such knowledge and acquiescence as a viable consideration.

> As to knowledge or acquiescence of officers of the Federal Government little need be said. The fact that Congress through utilization of the precise methods here employed could seek to reach these same objectives sough by respondents does not mean that respon-



> dents or any other group may do so without specific Congressional authority. Though employees of the government may have known of those programs and winked at them or tacitly approved them, no immunity would have thereby been obtained. Otherwise national policy on such grave and important issues as this would be determined not by Congress nor by those to whom Congress had delegated authority but by virtual volunteers. . . . . The fact that the buying program may have been consistent with the general objectives and ends sought to be obtained under the National Industrial Recovery Act is likewise irrelevant to the legality under the Sherman Act of respondents' activities . . . For as we have seen price-fixing combinations which lack Congressional sanction are illegal per se; they are not evaluated in terms of their purpose, aim or effect in the elimination of so-called competitive evils. 310 U. S. at 225-28.

In their program of "cost containment" for the retail pharmaceutical industry, Petitioners likewise seek to usurp the role of Congress and are acting as volunteers to determine a matter of national policy. They cannot be allowed to do so under the fiction that they merely are engaging in the business of insurance.

### E. Congress Did Not Intend To Sacrifice Price And Other Forms of Competition In Provider Industries To The Whims of Insurers And State Insurance Commissioners In Their Professed Search For Ways To Lower Insurance Rates

#### 1. The McCarran Act Does Not Vest Insurance Companies With A License To Impose Their Own Private System of Wage-Price Controls on Provider Industries

Petitioners and their amici contend "cost containment" is a primary responsibility of the "business of insurance."

*See, e.g.*, Amicus Curiae Brief of the Blue Shield Association (Brief of Blue Shield Association) at 10-11. They argue that insurance companies have a "responsibility" to "contain" the costs of "provider" industries. Although Petitioners and their amici speak mainly of containing health care costs, the National Association of Insurance Commissioners intimate that the "cost containment initiatives" or "experiments" should be expanded to other areas such as automobile repair. *See* NAIC Brief at 41-43. Among the insurance benefits currently in vogue are medical benefits, dental benefits, optional benefits, accident and sickness disability benefits, death benefits, and prescription drug benefits. Presumably these are all ripe areas for "cost containment experiments". Indeed, the number of industries that would be affected by this Court's holding Petitioners' challenged activities to be the business of insurance is staggering. Any industry selling goods or services that are purchased in whole or in part by the proceeds of insurance is a potential target for insurers' prices fixing activities — or "cost containment experiments."

Congress never intended that the McCarran Act or any other act serve as a vehicle whereby insurance companies, large labor unions, and large employers could combine with the larger members of a provider industry to determine what prices should be charged by that industry. Congress never intended that the McCarran Act oust the protections of the federal antiturst laws from every industry selling goods or services that are purchased with the proceeds of insurance. The legislative history of the McCarran Act shows no feeling in Congress that insurers or state insurance regulators are somehow magically endowed with the resources and broad expertise necessary to determine what constitutes a fair market price in the various non-insurance sectors of our economy.



Petitioners' "cost containment" activities fly in the face of the basic philosophy underlying the antitrust laws — that unrestricted competition will yield the most efficient allocation of eonomic and other resources, the highest quality of goods produced, and the *lowest prices*. Repeatedly, the Court has recognized this philosophy of the antitrust laws.

> The Sherman Act reflects a legislative judgment that ultimately competition will not only produce lower prices, but also better goods and services. . . . The assumption that competition is the best method of allocating resources in a free market recognizes that all elements of a bargain — quality, services, safety, and durability — and not just the immediate cost, are favorably affected by the free opportunity to select among alternative offers. Even assuming occasional exception to the presumed consequences of competition, the statutory policy precludes inquiry into the question whether competition is good or bad. *National Society of Professional Engineers V. United States*, ..... U.S. ....., 98 S. Ct. 1355, 1376 (1978)

Petitioners would have the Court believe that Congress, in enacting the McCarran Act, intended to displace this philosophy and to replace it with a system whereby insurance companies would be allowed to determine what forms of competition are to be allowed, what prices are to prevail and even what businesses would be allowed to exist. It is incredible to argue that Congress intended to establish a system of private economic regulation for all "provider industries," subject only to the State insurance commissioners' oversight.

The threat to our free economy that would be imposed by the Court's sanctioning Petitioners' private system of economic regulation is enormous.

> If a decision is to be made to sacrifice competition in one portion of the economy for greater competition in

> another portion this is a decision that must be made by Congress and not by private forces or by the courts. *United States v. Topco Associates, Inc.*, 405 U. S. 596, 611 (1972).

Respondents respectfully submit that Congress has not demonstrated a desire to sacrifice competition in provider industries for the benefit of insurance companies or for the benefit of large labor unions and large employers. Such an intention by Congress is not to be lightly implied. More is at stake here than abstract innocuous principles.

> Antitrust laws in general, and the Sherman Act in particular, are the Magna Carta of free enterprise. They are as important to the preservation of economic freedom and our free-enterprise system as the Bill of Rights is to the protection of our fundamental personal freedoms. And the freedom guaranteed each and every business, no matter how small, is the freedom to compete — to assert with vigor, imagination, devotion, and ingenuity whatever economic muscle it can muster. Implicit in such freedom is the notion that it cannot be foreclosed with respect to one sector of the economy because certain private citizens or groups believe that such foreclosure might promote greater competition in a more important section of the economy. *United States v. Topco Associates, Inc.*, 405 U. S. 596, 610 (1972).

Petitioners desire to do away with the concept that the essence of the business of insurance is the underwriting of risks in return for a premium. They want to convert insurance companies into massive cooperative buying units or purchasing agents, with McCarran Act licenses to utilize the threat of boycotts by their many insureds to coerce entities in provider industries to set their prices at levels determined by insurers, large labor unions, large employers, and the



larger members of the provider industries. The McCarran Act cannot serve as a license for such tampering with free market forces.

In August, 1971, wage-price controls were imposed on most sectors of the economy. In April, 1974, price controls were lifted from the health indusrty. They were not lifted with a mandate to Blue Shield, the UAW, the Motor Vehicle Manufacturers, and the large pharmacy chains to impose their own private price controls and market allocation schemes on the retail pharmaceutical industry.

### 2. State Insurance Commissioners Do Not Have A Congressional Mandate To Determine What Prices And What Forms of Competition Are To Prevail In The Various Industries Selling Goods That Are Purchased With The Proceeds of Insurance

Petitioners and their amici intimate that any abuses arising from Petitioners' challenged activities will be held in check by the State Insurance Commissioners. They argue that their challenged activities must be immunized from antitrust scrutiny as the "business of insurance" or State Insurance Commissioners will be hindered in their efforts to regulate insurance rates, and state regulation of the insurance will be disrupted.

These arguments are fallacious. Petitioners' challenged activities have nothing to do with an insurance commissioner's regulating the rates of insurancee. The speciousness of the arguments is underscored in the context of this case by the fact that the Texas State Board of Insurance *does not* regulate rates for accident and health insurance nor for prepaid presoription drug insurance (Pogue Depo. at 64), and it does not regulate the amounts to be paid to providers of benefits under health and accident insurance policies

(Pogue Depo. at 59-60). By no stretch of the imagination can Petitioners argue that their challenged activities are being undertaken in response to duress, request, or even simple urging by the Texas Commissioner of Insurance. The Commissioner does not even have authority to regulate Blue Shield's rates in Texas, much less urge or tacitly approve the activities challenged herein.

The Blue Shield Association's argument that the Court's subjecting Petitioner's challenged activities to scrutiny under the federal antitrust laws will interfere with State Insurance Commissioners' regulation of insurers' raes is ludicrous in light of responses by the Association's members to rate regulation. When the Commissioner of Insurance in Michigan recently tried to regulate the premium rates of Blue Cross and Blue Shield of Michigan, he was met with the following argument by that company:

> [T]he Commissioner's rate approval powers are limited to investigating whether the rates proposed will provide sufficient revenues to administer and fund benefits which BCBSM has determined and contracted to provide and to maintain the reserve levels approved by the Commissioner. Brief on Appeal — Appellant at 6, *Blue Cross and Blue Shield of Michigan v. Demlow*, Cause No. 59320 (Mich. Sup. Ct., filed 1977).

He was met with the additional argument by Blue Cross and Blue Shield that *it is not an insurance company* and is not subject to broad regulation by the Commissioner of Insurance! *Id.* 12. One can only conclude that Petitioners want as little regulation of their activities as possible. When faced with a choice between scrutiny under the federal antitrust laws and the minor inconveniences posed by State Insurance Commissioners ,they strenuously clamor for the latter.



The State Insurance Commissioners are receptive to this clamor because they are interested in expanding their authority at the expense of the federal antitrust laws. The NAIC argues that it and not the federal courts should determine what constitutes the "business of insurance" in the arena of insurer's activities ostensibly aimed at "cost containment." NAIC Brief at 45-47. Under the NAIC standard, *any* activities undertaken by insurers with the motive of reducing the cost of insurance is the "business of insurance" regardless whether the activity's focus is on another industry.

Although Congress clearly intended to give the States power to regulate insurance rates free from federal interference, it never intended to vest States or their Insurance Commissioners with preeminent exclusive regulatory authority over the prices, wages, and competitive activities in all private, non-insurance industries selling goods or services that might be purchased with the proceeds of insurance policies. Congress did not intend to remove the protections of the federal antitrust laws from these private non-insurance industries. To hold otherwise would allow the McCarran Act exception to swallow a huge portion of our free market economy.

Virtually any interaction between insurers and private, non-insurance industries will have some effect on an insurer's costs of doing business and hence its rates. That fact, however, is insufficient to substitute state regulation of private, non-insurance industries for that of the federal antitrust laws.

The McCarran Act's legislative history demonstrates that Congress never intended to install State Insurance Commissioners as the ultimate arbiters of insurance companies'

efforts to fix prices and eliminate competition in private, non-insurance industries. There was no expression of confidence in the efficacy of such regulation as a substitute for free market forces. The Act's history demonstrates a desire to circumscribe the State's regulatory authority within narrow, traditional parameters.

> It is not the intention of Congress in the enactment of this legislation to clothe the States with any power to regulate or tax the business of insurance beyond that which they had been held to possess prior to the decision of the United States Supreme Court in the Southeastern Underwriters Association case . . . In other word, we give to the States no more powers than those they previously had, and we take none from them. 91 CONG. REC. 1442 (1945) (remarks of Senator McCarran).

The desire obviously arose from a distrust of the competitive evils that would be wrought by a broad exemption.

> Mr. Speaker, this bill is a compromise, but it is well to keep in the background the tremendous power and potency of the various large insurance companies. We have to make a decision sooner or later as to whether or not we are going to be ruled by a cabal or a combination of these powerful companies or whether we are going to allow the small independent companies to function under competitive conditions in the various States. 91 CONG. REC. 1087 (1945) (remarks of Congressman Celler).

> The proponents of this legislation take too much for granted. Because the insurance officials of a few States, whose political policy is controlled and directed by the ramifications of these huge insurance combines, approve the McCarran bill, they would have the Members of Congress believe that a satisfactory agreement has been



> reached and that this bill has been sugar-coated so it pleases everybody. I doubt seriously if any of the "sugar" got into the bill. I shall later show how and why it will be "sour grapes" to the little businessman in the cities, villages, and at the crossroads who cannot pay his Federal, State, and local taxes, and at the same time pay tribute to these insurance barons. 91 CONG. REC. 1091 (1945) (remarks of Congressman Bailey).

Against such background, Petitioners and their amici would have the Court believe that Congress intended to sacrifice price and other forms of competition in provider industries to the whims of insurers and State insurance commissioners in their professed search for ways to lower insurance rates. The proposition is repugnant to reason and reality.

These same insurance commissioners who desire to control prices and competition in provider industries have been less than fervent in their efforts to control the rates of Blue Cross and Blue Shield — an activity clearly within the business of insurance. In 1971, the net income of Blue Cross plans was $85 million. In just the one year 1971 to 1972 alone this income rose by more than 276% to $230 million. In the two years from 1971 to 1973, the net income of Blue Cross plans increased by over 415% to $438 million! Mueller, *Private Health Insurance in 1973: A Review of Coverage Enrollment and Experience*, 38 SOC. SEC. BULL. 21, 34 (Feb. 1975). It must be noted that these figures for net income are very conservative since they do not include the amounts placed in reserves, which have likewise dramatically increased. The Blue Cross plans' reserves increased by 41% in the one year from 1971 to 1972, from $747 million to $1.05 billion. Mueller, *Private Health Insurance in 1972: Health Care Services, Enrollment and Finances*, 37 SOC. SEC. BULL. 20, 36 (March 1973). In

1973, the reserves rose an additional 40% to $1.46 billion. Mueller, *Private Health Insurance in 1973: A Review of Coverage Enrollment and Experience*, 38 SOC. SEC. BULL. 21, 34 (Feb. 1975).

These figures are not at all surprising when one analyzes the relationship between the NAIC and the Blue Cross-

Blue Shield organizations in whose behalf it has filed an amicus brief herein. During the 1974 NAIC convention, several newly appointed insurance commissioners questioned the standard practice of having more insurance company representatives at NAIC meetings than State regulators. Their suggestion that the regulators meet separately from the representatives of the industry they were purportedly regulating was rebuffed since the insurance industry is the major source of the information on which the NAAIC depends and provides money for the conventions and other NAIC activities. S. LAW, BLUE CROSS *WHAT WENT WRONG?* 164 (2d ed. 1976).

State insurance commissioners do not have the resources or the expertise to regulate prices and competition in the multitude of provider industries. State insurance commissioners do not have the resources to analyze each of these industries in the detail necessary to determine what is a "fair" market price. They do not have the expertise to determine what prices will give a "fair" return on capital in each of these industries. The underlying costs, which an industry's prices must reflect, change from day to day as well as from hour to hour. How could state insurance commissioners continually monitor the multitude of provider industries to determine when each one's expenses had risen sufficiently that a price increase would be allowed?



On page 48 of its amicus brief, the NAIC expresses it view that the $2.00 professional dispensing fee agreed upon by Petitioners is bound to be "an adequate level of reimbursement" because such figure was agreed upon "by several pharmacies including certain individual Respondents." This statement concerning adequacy of the $2.00 dispensing fee shows a fatal lack of understanding concerning the retail pharmacy industry and flies in the face of Congressional studies. In answering a similar expression of opinion, one Congressional report noted the following:

> Likewise overlooked in the Department of Justice's economic analysis is the different emphasis competing providers of pharmacy services place on the importance of their prescription counter's profits. To the small, independent retail pharmacist, dispensing medicine is the essence of his business. The profits derived from this service are the basis of his income and enable him to continue operating as a small businessman. Whatever else is sold in his store is primarily done so because the pharmacist wishes to offer his customers the convenience of purchasing some essential items in the same place that they have their prescriptions filled . . . But in some cases, the existence of a prescription counter is a peripheral item; there as a service to customers who have come into the store to buy other items. Indeed, its existence may really only be means of attracting customers into the store knowing that they will purchase other items while waiting for their prescriptions to be filled. Under such circumstances, the profits directly derived from dispensing drugs may not be as important as the indirect profits which result from purchasing of other items. As the prescription counter may only be a come-on, this type of store would be willing to sustain only marginal profits from the operation of this department, knowing that the volume of business generated by its presence will produce

profits in other departments which will justify the cost of installing a prescription counter. As profits are not the primary consideration for the existence of a prescription counter in this type of store, they can hardly be considered a significant factor in inducing this store to partcipate in a third-party program. Indeed, these programs may be a financial boom to such stores, in that they assure some profits for dispensing drugs. The Department of Justice has yet to acknowledge that profits are not always the major motivation for the existence of prescription counters in some stores and the fact that such situations exist places the independent retail pharmacist in a seriously disadvantageous competitive position to the extent that they jeopardize his continued existence as a small businessman.

> The independent retail pharmacist's problems become more acute when a store which establishes a prescription counter as a come-on to attract customers agrees to participate in a third party prepaid prescription program, for once this happens, the small independent pharmacist has, in effect, lost his freedom of choice and is now compelled by the economic realities of an unbalanced competitive market to participate. Since the prescription counter is the basis of his business, the loss of existing clientele would mean financial ruin, while to the large competitor, participation only offers an opportunity to increase the volume of a marginally profitable department. Thus, to the independent, participation may offer the only mechanism for economic survival and may necessitate the incursion of diminished profits as the only means of staying in business. *Problems of Third Party Prepaid Prescription Programs* at 13-14.

Elsewhere, the report noted that "because of the inflexibility in the method of determining his fee, participation in third



party programs may also result in financial failure. Herein lies the essence of the pharmacist's dilemma." *Id.* 6.

The NAIC's lack of understanding of the retail pharmacy industry is not surprising. After all, in pushing for "cost containment experiments" in provider industries, the NAIC is not seeking to further the competitive health of the provider industries. The NAIC has but one interest—each insurance commissioner is on the "public 'firing line' " to make reliable insurance available at low rates. *See* NAIC brief at 46. The fact that lower insurance rates might be achieved at the expense of competition in prices and customer services in provider industries and at the expense of society's losing small, independent businessmen is of no concern to the insurance commissioner. His performance is not measured in terms of these parameters. He is not accountable to the provider industries nor to the public for performance of these industries. To hold that Congress intended these individuals to sit as final arbiters over conspiracies between insurers and large providers to fix prices and eliminate competition in customer services in provider industries is repugnant to all reason. Congress could not have intended that the McCarran Act effect so broad a retreat from the Sherman Act, for, as this Court has articulated,

> In enacting the Sherman Act, . . . Congress mandated competition as the polestar by which all must be guided in ordering their business affairs. It did not leave this fundamental national policy to the vagaries of the political process, but established a broad policy, to be administered by neutral courts, which would guarantee every enterprise the right to exercise 'whatever economic muscle it can muster,' . . . without regard to the amount of influence it might have with local or state legislatures. *City of Lafayette v. Louisiana Power &*

*Light Co.*, U. S. , 98. S. Ct. 1123, 1133-34 (1978), *quoting in part United States v. Topco Associates, Inc.*, 405 U. S. 596, 610 (1972).

### F. The McCarran Act Does Not Automatically Immunize Every Aspect of Contractual Relationships Between Insurers and Providers Of Benefits From Scrutiny Under The Federal Antitrust Laws.

Petitioners argue that the Fifth Circuit's Decision "stands alone in its unrealistic attempt to separate the health care provider agreement from the underlying contract of insurance." Brief for Petitioners at 25-26. They further argue that "all other courts have uniformly held that participating agreements" between insurers and providers "are an integral part of the 'business of insurance.'" Brief for Petitioners at 26-27. Petitioners' arguments misconstrue the Fifth Circuit's decision, overlook other relevant judicial decisions and attribute a breadth to cited decisions that just is not present.

There is no body of precedent holding that all contracts between insurance companies and providers of benefits, which in some manner concern the provision of benefits, are automatically immune from antitrust scrutiny with respect to *all activities and conspiracies* embraced or contemplated by the contracts. Petitioners desire that this Court grant such blanket McCarran Act immunity. The Fifth Circuit refused to cripple the economic freedoms guaranteed by the federal antitrust laws in the manner urged by Petitioners. It recognized that federal courts cannot allow insurer's ingenious exercises in packaging or camouflaging to remove from federal antitrust scrutiny that which is not the business of insurance. There is nothing sacred about "provider agreements" that precludes a federal court's looking beyond their



surface to see if they embrace or contemplate activities that are not a part of the business of insurance and thus not entitled to McCarran Act immunity. The Fifth Circuit did not hold that all "provider agreements" and all aspects of such agreements are outside the business of insurance. Rather, it held that federal courts must scrutinize challenged activities to see if they, regardless of the window dressing, are a part of the business of insurance. "[S]uch practices do not become clothed with McCarran Act protection *simply because* an insurance company has contracted to pay the provider for products or services." 556 F. 2d 1386, App. 137a, (emphasis added).

Petitioners want the Court to expand the McCarran Act's immunizing effects by granting blanket antitrust exemptions for any and all activities embraced or contemplated by contracts between a health insurer and providers of benefits. Petitioners' "provider agreement" argument is contrary to the McCarran Act. It would make antitrust immunity dependent solely on the existence of contractual arrangements between an insurer and non-insurance parties, not on satisfaction of the McCarran Act's requirements. It would mean that any direct contract between an insurer and providers of benefits automatically would exempt the contracting parties from the federal antitrust laws, irrespective whether the various activities contemplated by the parties actually are a part of the "business of insurance" as the McCarran Act requires. It thus creates an antitrust exemption not conferred by Congress. While Petitioners' argument has the virtue of simplicity, it is patently invalid and finds no support in the McCarran Act. Activities do not become a part of the "business of insurance" merely because they are contemplated or embraced by a contract to which an insurer is a party.

A second fallacy of Petitioners' argument is its premise that the activities challenged by Respondents are "an inseparable feature of prepaid health policies which are regulated by the states." The Fifth Circuit correctly found that the price fixing and coercion practiced by Petitioners are *not* an inseparable feature of Blue Shield's health insurance policies, are not peculiar to the "business of insurance and are not regulated by Texas as a part of the "business of insurance."

The setting of retail prices in the various private sectors of our economy certainly is not encompassed by the business of insurance. As the Fifth Circuit correctly recognized, an insurer "is not required to guarantee the provision of services on a 'cost-plus' basis or any other basis which might be more economical than the retail purchase of such products." (556 F. 2d at 1382, App. 129).

Contrary to Petitioners' assertions, there is no great body of precedent holding that "provider agreements" are inseparable from the underlying contract of insurance and, *together with all their attendant activities*, are automatically a part of the business of insurance. Each of the cases cited by Petitioners involved its own unique set of facts and of state law. To the extent any of the cases recognized activities such as those challenged herein to be the business of insurance, Respondents respectfully submit that the cases were wrongly decided.

One case, more than any other, is cited as authority justifying McCarran Act immunization of insurers' perversions, permutations, and abuses of "provider agreements." That case is *Travelers Ins. Co. v. Blue Cross*, 481 F. 2d 80 (3d Cir.), *cert. denied*, 414 U. S. 1093 (1973). Petitioners heavily relied on *Travelers* in the Fifth Circuit and again cite the



case in their brief before this Court. *Travelers* is an unfortunate case because it is all too easily misconstrued and stretched beyond its limited holding. *Travelers* involved a very special fact situation wholly unlike that before this Court. It cannot be cited for the proposition that contractual relationships between insurers and the providers of benefits, which relate in some manner to the provision of benefits, necessarily constitute the business of insurance. To cite it for this proposition is to ignore the case's specialized factual setting and the fact that the Third Circuit's holding is in reality a very narrow one based on unique features of Pennsylvania Law.

It is true that *Travelers* involved a direct contractual relationship between an insurer and the providers of benefits. However, the similarity between that case and the present controversy ends with this single characteristic. The fact that there was a *direct contractual relationship* between Blue Cross and the providers of benefits, some non-profit hospitals, did not in itself serve on the basis for the Third Circuit's opinion. Only after one reads the District Court's opinion in *Travelers*, and thereby gains an understanding of the highly specialized facts in that case, can the true basis of the Third Circuit's opinion be understood. *See Travelers Ins. Co. v. Blue Cross*, 361 F. Supp. 774 (W.D. Pa. 1972), *aff'd*, 481 F. 2d 80 (3d Cir.), *cert. denied*, 414 U.S. 1093 (1973).

In a case decided by the United States District Court for the Eastern District of Pennsylvania, the Court correctly observed that the decision in *Travelers* was based on the specialized provisions of Pennsylvania law — provisions having no counterpart in Texas and that are totally alien to the facts of the present controversy. *See Doctors, Inc. v. Blue Cross*, 431 F. Supp. 5 (E. D. Pa. 1975), *aff'd per curiam*,

557 F. 2d 1001 (3d Cir. 1976). The Court in *Doctors, Inc.* correctly construed the narrowness of the Third Circuit's holding in *Travelers*, with the following observation:

> It is therefore readily apparent from the reading of the *Travelers* case that *the Third Circuit is approving the actions of the Insurance Commissioner of Pennsylvania* when he exerts pressure on the large insurance companies to get them to exercise their power over hospitals to cut costs wherever possible.

431 F. Supp. at 10 [emphasis added]. The fact that there was a direct contractual relationship between Blue Cross and the non-profit hospitals was not in itself important.

Of crucial importance to the *Travelers* opinion was the fact that *Pennsylvania's legislature had chosen to control the rates charged by non-profit hospitals* through a statutorily created interrelationship between the rates charged by non-profit health insurers and non-profit hospitals, which interrelationship was to be regulated by the Pennsylvania Insurance Department. As the District Counrt observed in *Travelers*,

> "the activities of Blue Cross in all respects material to this case, *including the terms of the contract under attack*, are regulated and *directed* by the Insurance Department of the Commonwealth of Pennsylvania in strict conformity with the provisions of the Nonprofit Hospital Plan Act of 1973 . . ."

*Travelers Ins. Co. v. Blue Cross*, 361 F. Supp. 774, 776 (W. D. Pa. 1972) [emphasis added]. Additionally, it observed the following with respect to Pennsylvania's Nonprofit Hospital Plan Act:

> Under the terms of said Act, Blue Cross having been previously organized under the Pennsylvania Nonprofit Corpoartion Law . . . for the purpose of establishing, maintaining and operating such a *non-profit hospital plan* became subject to regulation by the Pennsylvania Insurance Department in the following respects:
>
> 'the rates charged to subscribers . . ., *all rates of payments to hospitals . . ., and any and all con-contracts entered into . . . with any hospital.' . . . The Blue Cross Hospital contract is, therefore, an integral part of Pennsylvania's regulated hospital plan.*"



361 F. Supp. at 777. [emphasis added]. It can be seen, then, that the Pennsylvania legislature had chosen to directly control the rates charged by non-profit hospitals by charging the Insurance Department with the task of directing and controlling the terms of contracts between *non-profit* health insurers and non-profit hospitals and with controlling the rates of payments by insurers to non-profit hospitals.

The role of the Pennsylvania Insurance Department in determining the terms of Blue Cross' contracts with non-profit hospitals is very extensive as is shown in *Frankford Hospital v. Blue Cross*, 1976-2 Trade Cases ¶ 61,030 at 69,547 (E.D. Pa. June 8, 1976), *aff'd*, 554 F. 2d 1253 (3rd Cir.), *cert. denied*, ..... U.S. ....., 98 S. Ct. 186 (1977). *Frankford* involved a challenge by a non-profit hospital to Blue Cross' contract with hospitals. The District Court relied on the *Travelers* opinion and stressed as follows:

> "Both the rates Blue Cross charges to subscribers and its rate of payments to hospitals must be approved in advance by the Insurance Department before they can go into effect. 40 Pa. C.S.A. ¶6124. . . . The Department instructed Blue Cross to develop a uniform contract [with non-profit hospitals]. It particularly

> stressed that this contract should include the cost accounting principles upon which reimbursement under the federal Medicare Program was based."

5 Trade Reg. Rep. at 69,548. The Court noted that when Blue Cross first submitted its proposed uniform cost contract between itself and Philadelphia area hospitals, the contract was rejected by the Insurance Commissioner, who instructed Blue Cross that it was not to pay for any portion of the hospitals' unreimbursed outpatient cost or for costs of depreciation. The Commissioner viewed these costs as a "community responsibility, including federal, state and local governments as well as eleemosynary institutions . . ." 5 Trade Reg. Rep. at 69,549.

Finally, the Hospital Agreement of 1971 was approved, "the terms of which reflected Commissioner Denenberg's negotiating guidelines.. *Id.* When the 1971 Agreement expired in 1974, a number of hospitals refused to sign a new hospital agreement with Blue Cross, in response to which "the Commonwealth of Pennsylvania enacted Act. No. 94 of 1975, (40 P.S. ¶ 6124c). It reinstated, retroactively, the 1971 Hospital Agreement between Blue Cross and the non-member DVHC hospitals." 5 Trade Reg. Rep. at 69,550.

It was against this factual background, then, absent the 1975 statute, that the Third Circuit in *Travelers* held the contract between a non-profit health insurer and non-profit hospitals to be shielded by the McCarran Act from attack. Considering this factual background, it is evident that the *Travelers* opinion is of no precedential value in the present controversy and certainly cannot be cited for the broad proposition that contractual relationships between an insurer and a provider of benefits are *ipso facto* shielded by the McCarran Act from antitrust challenge. The mere fact



that a conspiracy to fix prices is embodied in an agreement between an insured and a provider does not invoke McCarran Act immunity. The Third Circuit in *Travelers* was not confronted with a conspiracy to fix prices; nor was it confronted with a conspiracy to coerce providers of benefits to fix their prices. It was confronted with a *State created* and *State controlled* plan for not only regulating, but mandating, the rates charged by non-profit hospitals. The State legislature had expressly provided that Pennsylvania's Insurance Department would control and *direct* the terms of contracts between non-profit insurers and non-profit hospitals and had expressly created an interrelationship between non-profit health insurers' rates and those of non-profit hospitals, which interrelationship was also to be regulated by the Pennsylvania Insurance Department. Given this background, there can be no doubt that the terms of the contract challenged in *Travelers* were in effect created by the Pennsylvania legislature as a part of the non-profit health insurance and non-profit hospital plans in Pennsylvania. Activities such as those challenged herein were not before the Third Circuit in *Travelers.*

Texas has no plan even remotely analogous to that of Pennsylvania as concerns pharmacies, the rates charged by pharmacies, the rates charged by prescription drug insurers, and the interrelationship of the rates charged by pharmacies and insurers. Unlike the Pennsylvania plan involving *non-profit hospitals* and *non-profit insurers*, there is no statute in Texas by which the legislature seeks to control directly or indirectly the prices charged by retail pharmacies. Retail pharmacies are an entirely private sector of the economy, are not subsidized in whole or in part by the State, and operate for profit. There is no statute in Texas by which the legislature seeks to control the premium rates for Blue

Shield's prescription drug insurance nor the amounts of Blue Shield's reimbursements for prescription drugs. The Texas legislature has not chosen to indirectly or directly control the rates charged by pharmacies by directing and controlling contracts between insurers and pharmacies and by creating an interrelationship between the rates charged by pharmacies and those charged by insurers. As Blue Shield's house counsel admitted in deposition testimony, Texas law does not require that the Pharmacy Agreement be submitted to or approved by the State Board of Insurance (McDonald Depo. at 57, App. 302a). In short, the State of Texas *has not regulated, authorized, directed, sanctioned, nor created* the Pharmacy Agreement that is under scrutiny in this case. The Commissioner of Insurance has not directed Blue Shield to force pharmacies to cut costs wherever possible. The Texas legislature has not attempted to make contracts between insurers and pharmacies part of the business of prescription drug insurance. None of the factors in *Travelers* are present in this case. We are dealing with a wholly private sector of the economy, unlike the situation in *Travelers* involving non-profit hospitals, who are underwritten to a large extent by public and charitable funds. We are dealing entirely with private actions, those of volunteers who seek to set prices and eliminate competition by virtue of their conspiracy and coercion.

It is a gross perversion of the Third Circuit's language to cite *Travelers* for the proposition that a price fixing conspiracy between a profit-making insurance company and profit-making pharmacies is part of the business of insurance as long as it is embodied in a "provider agreement." *Travelers* cannot be cited for the proposition that the McCarran Act immunizes all activities that "provider agreements" embody or contemplate. *Travelers* involved none of the activities challenged herein.



Two of the cases relied on by Petitioners to support their proposition concerning blanket McCarran Act immunity for "provider agreements" merely are progeny of *Travelers*. *See Doctors, Inc. v. Blue Cross*, 557 F.2d 1001 (3d Cir. 1977), *aff'g. per curiam* 431 F. Supp. 5 (E.D. Pa. 1975); *Frankford Hospital v. Blue Cross*, 554 F.2d 1253 (3d Cir.), *cert. denied*, ..... U.S. ....., 98 S. Ct. 186 (1977). Both cases involved non-profit hospitals, unique features of Pennsylvania law, and Pennsylvania's Nonprofit Hospital Plan Act. In each case, the Third Circuit succinctly stated it was merely following its *Travelers* holding.

Petitioners' reliance on *Anderson v. Medical Service of the District of Columbia*, 551 F.2d 304 (4th Cir. 1977), *aff'g per curiam*, 1976-1 Trade Cases ¶ 60,884, at 68,855 (E.D. Va. 1976), to create a conflict with the Fifth Circuit's decision is also misplaced. Although *Anderson* did involve direct contractual relationships between an insurer and the providers of benefits, physicians, the opinion was not based on the mere fact that the challenged activity was embodied in a "direct" contract between an insurer and providers of benefits nor on the alleged inseparability of "provider agreements" from the underlying contract of insurance. The district court in *Anderson* stressed the fact that the challenged activity did not operate to fix prices. The court further stressed that the insureds were not coerced to patronize participating physicians *and that policy benefits were the same* whether the subscriber patronized a participating or non-participating physician. 5 Trade Reg. ¶ 60,884, at 68, 857. The fact situation in *Anderson* differs markedly from this case where prices are fixed and Blue Shield's subscribers

must pay a sizeable financial penalty in the form of markedly reduced policy benefits if they patronize non-participating pharamacies.

Another of the "conflicting" decisions cited by Petitioners is *Proctor v. State Farm Mut. Auto Ins. Co.*, 561 F.2d 262 (D.C. Cir. 1977), *petition for cert. pending*, No. 77-580. *Proctor* cannot be cited for the proposition that all *direct* contractual arrangements between insurers and providers of benefits are automatically a part of the "business of insurance" as Petitioners imply. *See* Brief for Petitioners at 26 n. 23. Rather, the D. C. Circuit emphasized that "[t]he question [whether an activity is part of the 'business of insurance'] is ultimately one of line-drawing, based on the facts of the individual case." *Id.* at 268. The D. C. Circuit cited the District Court's opinion in this case with approval, but did so prior to the Fifth Circuit's correcting the erroneous statements of fact on which the District Court's legal conclusions were premised. If it had been given the benefit of the facts as they actually exist, the D.C. Circuit most assuredly would not have cited the District Court's opinion with approval.

*Proctor* involves a challenge to a "horizontal agreement [among insurers] to pay or reimburse their policyholders according to a common formula." *Id.* at 264 (emphasis added). In essence, the case involves a challenge to insurers' conspiring among themselves concerning the maximum dollar amount of coverage the insurers will provide per claim for their insureds. The present cause, by contrast, involves a challenge to a conspiracy between an insurer and retail pharmacy chains concerning the retail prices to be charged by the retail pharmaceutical industry for its goods and services. There is no indication that the D. C.



Circuit would consider the later activity to constitute the business of insurance. Additionally, *Proctor* lacks the coercive conduct utilized by Petitioners in their effecting a boycott by Blue Shield's subscribers of pharmacies that refuse to agree on price.

The final case relied on by Petitioners as supporting blanket McCarran Act immunity for "provider agreements" and their attendant activities is *Manasen v. California Dental Services*, 424 F. Supp. 657 (N.D. Calif. 1976), *appeal pending*, Nos. 77-1751 and 77-1752 (9th Cir.), which also relied on the District Court's opinion in this case.

Although *Manasen* does indeed appear to support Petitioners arguments, Respondents submit that *Manasen* was incorrectly decided for the reasons so ably articulated by the Fifth Circuit herein. *See* 556 F.2d at 1385-87, App. 136a-138a.

### G. Petitioners' Activities As Challenged Herein Are Not Peculiar To The Insurance Industry And Are Not The Business Of Insurance.

Petitioners desire that this Court articulate a rule of blanket McCarran Act immunity for contracts between insurers and providers and for all activities that such contracts might embrace or contemplate because their challenged activities, if subjected to scrutiny, can be no stretch of the imagination be considered the business of insurance. As the Fifth Circuit concluded,

> "[T]here is no indication that the activities complained of are considered the business of insurance . . . by any common sense interpretation of that term." (556 F. 2d at 1385, App. 135a)

By providing markedly decreased benefits to those subscribers who patronize a pharmacy that refuses to sign the price-fixing agreement, Blue Shield intentionally and overtly coerces its subscribers to boycott these pharmacies. This boycott operates to coerce the non-signing pharmacies to participate in the fixing of prices. Blue Shield effectively forecloses non-signing pharmacies from a significant portion of the market and secures for Participating Pharmacies the sales of prescription drugs required by Blue Shield's claimants. This activity is not peculiar to the insurance industry and does not constitute the business of insurance. When faced with very similar activity in *Hill v. Nat'l Auto Glass Co., Inc.*, 293 F. Supp. 295 (N.D. Calif. 1968), the District Court for the Northern District of California observed as follows:

> [I]t does not seem . . . that the alleged activity involved here, namely securing for particular glass dealers the sales and installation jobs required by Allstate claimants, is a part of the "business of insurance" as that term is normally understood." *Id.* at 296.

The conspiracy and agreement to secure for those pharmacies that have signed the price-fixing agreement the sales of prescription drugs to Blue Shield's subscribers is likewise not the business of insurance. The connection of this activity to the insurance company/policyholder relationship is attenuated. The primary relationships affected are those between competing pharmacies and between the pharmacies and their customers — relationships outside the ambit of the McCarran Act.

In *DeVoto v. Pacific Fidelity Life Insurance Co.*, 516 F.2d 1 (9th Cir. 1975), the Ninth Circuit was faced with an antitrust suit by a New York insurance company, which challenged a combination between the defendant insurance



company and the defendant mortgage banker that effectively foreclosed the plaintiff insurance company from a significant segment of the California market for mortgage protection insurance. Despite the fact that the defendant's acts affected the relationship between an insurance company and prospective policyholders, the Ninth Circuit expressly upheld the District Court's finding that the activity was outside the ambit of the McCarran Act. 516 F.2d at 3. The defendants' acts in foreclosing a competitor from a substantial portion of the market were held to be peripheral to the business of insurance and thus without the protective scope of the McCarran Act. The Court's holding in *DeVoto* applies with full force to Petitioners' activities as challenged herein. The price fixing agreement, coupled with the coercion of Blue Shield's policyholders, effectively forecloses pharmacies that refuse to agree on prices from selling prescription pharmaceuticals to Blue Shield's subscribers. These activities are indistinguishable from those before the Ninth Circuit. As was the case in *DeVoto*, the challenged activities are peripheral to the business of insurance and are thus outside the McCarran Act's protective scope.

In *Battle v. Liberty Nat'l Life Ins. Co.*, 493 F.2d 39 (5th Cir. 1974), *cert. denied*, 419 U.S. 1110 (1975), the Fifth Circuit confronted a fact situation markedly similar to that in this case. *Battle* was an action by several funeral homes and directors against an insurer, which issued burial policies, and the insurer's wholly owned subsidiary, which supplied merchandise and services required by the insurer's policies. When the funeral homes signed contracts with the insurer's ssubsidiary to purchase merchandise and services required by the insurer's policies, they became "authorized" funeral homes for purposes of servicing and furnishing merchandise to the insurer's policyholders. If they refused to contract

with the subsidiary, they were considered "unauthorized" homes. Services provided under the policy differed significantly, depending on whether an insured used an "authorized" or "unauthorized" funeral home. Plaintiffs sought relief under the Sherman and Clayton Acts.

The Fifth Circuit's holding with respect to the insurer's discrimination in benefits, which directly applies to the factual setting of this case, is as follows:

> "It appears that, since the insurance contract confers far more benefits upon the policyholder if he uses an authorized funeral home [pharmacy], the policyholder is subtly coerced into dealing only with the authorized home [pharmacy]. The imposition of this restraint would effectively foreclose the unauthorized funeral director's [pharmacies'] access to a substantial portion of the market." 493 F. 2d at 44-45.

These facts, "if established, would tend to support a finding of unreasonable restraint of trade." 493 F.2d at 44. The defendants sought to avoid the dictates of the Sherman and Clayton Acts by claiming that the McCarran Act exempted their activities from the federal antitrust laws.

Although the Fifth Circuit felt that the facts were inadequately developed to make a conclusive determination on the McCarran Act issue, it gave the following advice for the District Court's benefit on remand:

> "[I]t might be plausibly argued that these facts do not constitute the business of insurance as contemplated by the McCarran Act and thus do not fall within its exemption." 493 F. 2d at 50.

The Fifth Circuit served notice that the insurer "may have exceeded the business of providing burial insurance and encroached upon the business of providing funeral services."



493 F.2d at 50. Its feeling in this regard was prompted by the following observation concerning the insurer's arrangement.

> "[I]t requires the performance of duties beyond those encompassed by the business of insurance, duties that relate solely to the plaintiffs' businesses in the operation of their funeral homes, and thus the defendants' activities fall outside the McCarran Act exemption. While all these obligations are related to the business of insurance, we believe that they are so remotely related as to be subject to the antitrust laws." 493 F.2d at 50.

The Fifth Circuit's observation applies with particular force to the activities challenged herein.

It is curious that in their efforts to distinguish *Battle*, Petitioners presume to know more about the case than does the Fifth Circuit, from whence it came. Petitioners argue that the reasoning of *Battle* is limited to situations where there is no *direct* contract between the insurer and provider of services. Brief for Petitioners at 26 n. 23. This argument was made by Petitioners to the Fifth Circuit, and was rejected by that court. There is nothing unique about a *direct* as opposed to an indirect contract that would suddenly make activities or businesses not otherwise a part of the business of insurance eligible for McCarran Act immunity. The focus must be on the activities themselves. Such focus led the Fifth Circuit to correctly conclude as follows:

> [T]he activity complained of by plaintiffs is not peculiar to the insurance industry. To be sure, price fixing and coercion induced by firms with superior bargaining power are often found in all industries. Thus, Blue Shield's attempts to control costs in the pharmaceutical industry might just as easily be undertaken by a non-

insurance firm attempting to meet a contractual obligation to deliver drugs to a wholesale or retail purchaser. 556 F. 2d 1386, App. 138a.

### H. The Texas State Department of Insurance Does Not Consider The Pharmacy Agreement To Encompass Or Constitute The Business Of Insurance And Has Not Undertaken To Regulate It As A Part of Such Business.

Although the determination concerning what constitutes the "business of insurance", as that term is used in the McCarran Act, is a federal question,* and federal interpretations supersede those of the states, *see S.E.C. v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 69 (1959), it would be highly anomalous for a federal court to declare that an activity constitutes the business of insurance when a State's Department of Insurance has made the contrary determination. After all, the McCarran Act is merely intended to prevent federal interference with State regulation of the business of insurance. Congress wanted to assure that the activities of insurance companies in dealing *with their policyholders* would remain subject to state regulation." *S.E.C. National Securities, Inc.*, 393 U.S. 453, 459 (1969). If a State considers an activity not to constitute the business of insurance, federal regulation of that activity could not be construed as interference with with State regulation of the business of insurance. When a State makes the determination that an activity does not constitute the business of insurance, and thereby serves notice that the activity will not be regulated as a part of the business of insurance, the determination should be controlling with the federal courts. A contrary holding by the federal court would in no way further the purposes behind the McCarran Act. Application of the federal antitrust laws in this situation could in no



way be construed as invalidating, impairing, or superseding "any law enacted by any State for the purpose of regulating the business of insurance." *See* 15 U.S.C. § 1012(b) (1970). Additionally, it would violate the Supreme Court's mandate that the antitrust laws are to be liberally applied. *See Abbott Labs. v. Portland Retail Druggists Ass'n.*, 425 U.S. 1 (1976). The McCarran Act like other exceptions to the antitrust laws, is to be construed strictly and has no intendments in its favor.

That Texas does not consider the activities challenged herein to be the "business of insurance" cannot be doubted. The testimony of Mr. Pogue, Director of the Policy Approval Division of the State Board of Insurance, is unambiguous in this regard as is dicussed extensively elsewhere in this brief. Petitioners endeavor to create a contrary impression by citing various Texas statutes that are inapplicable to their challenged activities. With respect to TEX. INS. CODE ANN. art. 21.21 (1963), they argue as follows:

> [I]t was specifically intended by its draftsmen to respond to the invitation of the McCarran Act to withdraw from federal control *the very conduct attacked by respondents in this action* and to place such conduct under state control. Brief for Petitioners at 32-33 (emphasis added).

Petitioners overlook a crucial fact in this argument—article 21.21 only applies to activities that are a part of the business of insurance, which the activities challenged herein are not. The article provides as follows:

> Sec. 4. Unfair Methods of Competition or Unfair and Deceptive Acts or Practices Prohibited. — No *person* shall engage in this state in any trade practice which is defined in this Act as, or determined pursuant to this

> Act to be, an unfair method of competition or an unfair or deceptive act or practice *in the business of insurance.* TEX. INS. CODE ANN. art. 21.21 Sec. 3 (1963) (emphasis added).

"Person" is defined as follows:

> Any individual, corporation, association, partnership, reciprocal exchange, inter insurer, Lloyds insurer, fraternal benefit society, and any other legal entity *engaged in the business of insurance*, including agents, brokers, adjusters and life insurance counselors. TEX. INS. CODE ANN. art. 21.21 Sec. 2 (1963) (emphasis added).

There is absolutely no indication that Texas or its Department of Insurance considers Petitioners' challenged activities to be the business of insurance in order to invoke article 21.21.

Petitioners' conclusion that article 21.21 applies to the challenged combination and conspiracy to fix the prices of pharmaceuticals directly conflicts with the testimony of Mr. A. W. Pogue, who is the official charged with reviewing the documents within the jurisdiction of the State Board of Insurance "to make sure that they comply with the statutory requirements as set forth in the Insurance Code [including those of article 21.21]" (Pogue Depo. at 13, 33-34, App. 324a-325a, 335a-336a). Since Mr. Pogue is charged with screening documents within the jurisdiction of the Board of Insurance for compliance with article 21.21, and since, as is discussed extensively above, he takes the position that The Pharmacy Agreement is not a part of the business of insurance, it is difficult to understand how Blue Shield can argue that article 21.21 applies to The Pharmacy Agreement and its attendant price fixing activities.



Mr. Pogue's testimony reflects the reality of the situation. The Pharmacy Agreement and its attendant price fixing are not within the ambit of article 21.21 because they are not a part of the business of insurance in Texas. It would be highly anomalous for this Court to hold that article 21.21 applies to The Pharmacy Agreement when the State Board of Insurance has manifested a contrary interpretation.

Since the activities challenged herein do not constitute the business of insurance, the potential applicability of the Texas Antitrust Laws to such activities does not invoke the McCarran Act. Where challenged activities do not constitute the "business of insurance", the McCarran Act is inapplicable despite the existence of State legislation proscribing or otherwise regulating them. As one Court recently noted,

> "Even though the Commonwealth [Virginia] may have legislation similar to the Sherman Act and the Clayton Act, the McCarran-Ferguson Act does not oust the Court of jurisdiction unless the activities complained of, though prohibited by State legislation, are . . . a part of the "business of insurance" as defined in *National Securities." American Family Life Assurance Co. v. Planned Marketing Associates, Inc.*, 389 F. Supp. 1141 (E.D. Va. 1974).

*Accord, e.g., S.E.C. v. National Securities, Inc.*, 93 U. S. 453 (1969) (Court held that despite existence of an Arizona statute which regulated the challenged activity, the McCarran Act was nevertheless inapplicable due to the activity's not being the "business of insurance"); *S.E.C. v. Variable Annuity Life Ins. Co.*, 359 U. S. 65 (1959) (holding that challenged activities were not a part of the business of insurance despite fact that the defendants were regulated under the insurance laws of the District of Columbia and several other States; *Center Ins. Agency v. Byers*, 5 CCH

Trade Reg. Rep. ¶ 60,940 at 69,122, 69,123 n. 2 (N. D. Ill. June 10, 1976) (denying application of the McCarran Act despite the fact that the challenged acts were regulated by all states with which they came into contact.)

In their efforts to convince the Court that their challenged activities constitute the business of insurance, Petitioners make the unsupported allegations that "[v]irtually all states regulate . . . [prepaid health plans] under their insurance codes, including special legislation designed to further the states' cost containment objective." Brief for Petitioners at 25. It is true that many states regulate prepaid health plans under their insurance codes, but it is a gross perversion of fact to state that virtually all states have enacted legislation designed to contain costs in provider industries. Petitioners' lack of citation of authorities underscores the falsity of their statement and the inferences intended to be drawn from the statement.

Petitioners fail to inform the Court that despite their regulating nonprofit prepaid health care plans under their insurance codes, many states have stated unequivocally that these plans are not be considered in the "business of insurance." *Se, e.q., ALASKA STAT.* §21.87.060 (providing that "[n]o service corporation may have or use a corporate or business name which includes the words 'insurance,' 'casualty,' 'surety,' 'health' and accident,' 'mutual,' or other terms descriptive of an insurer *or insurance business.*") (emphas added); IDAHO CODE §41-3407 (1977) (stating that "[n]o service corporation shall have or use a corporate or business name which include the words 'insurance,' 'casualty,' 'surety,' 'health and accident,' 'mutual', or other terms descriptive of an insurance *or insurance business business*") (emphasis added); KENTUCKY REV. STAT.



§304.32-060 (1972) (stating that "[t]he name of the corporation shall not include the words 'insurance', 'casualty', 'surety,' 'mutual', or any other words descriptive of the insurance, casualty, or surety business"); MICH. COMPILED LAWS ANN. §550.303 (1967) (stating that the name by which such corporations shall be known is "not to include the words insurance, casualty, surety, health and accident, mutual *or other words descriptive of the insurance and surety business*") (emphasis added); MINN. STAT. ANN. §62C.04 Subd. 3 (Supp. 1977) (stating that "no service plan corporation shall include within its name the 'insurance', 'casualty', 'surety', 'mutual', 'indemnity', or any other words descriptive of the insurance, casualty, or surety business). The states have clearly precluded these nonprofit prepaid health care plans from holding themeselves out as engaged in the business of insurance. The States have wanted to make clear that the mere fact of regulation within the parameters of their insurance codes was not a determination that the entity was engaged in the business of insurance.

## II.

## THE LACK OF REGULATION BY TEXAS RENDERS PETITIONERS' CHALLENGED ACTIVITIES SUBJECT TO SCRUTINY UNDER THE FEDERAL ANTITRUST LAWS.

In order for an insurance company's activities to have McCarran Act immunity from scrutiny under the federal antitrust laws, the activities must be regulated by the State in addition to their constituting the "business of insurance." *See, e.q., Battle v. Liberty National Life Ins. Co.*, 492 F.2d 39, 49 (5th Cir. 1974), *cert. denied*, 419 U.S. 1110 (1975); *Travelers Ins. Co. v. Blue Cross*, 481 F.2n 80, 82

(3rd Cir.), *cert. denied*, 414 U.S. 1093 (1973). The McCarran Act provides that the Sherman and Clayton Acts "shall be applicable to the business of insurance *to the extent* such business is not regulated by State law." 15 U.S.C §1012(b) (1970). It is not enough for immunity merely that the State regulate the business of insurance in general. That State must regulate the particular challenged activities as part of the business of insurance. Congress carefully provided that the antitrust laws would apply "to the extent" the insurance business is not regulated by State law rather than "if" the insurance business is not regulated by State law. Congress served notice that the mere existence of "some" regulation is not in itself sufficient for immunity.

The McCarran Act renders the antitrust laws inapplicable when State legislation regulates the conduct in question (assuming it is the business of insurance) and authorizes enforcement through a scheme of administrative supervision. *F.T.C. v. National Casualty Company*, 357 U.S. 560 (1958). There is no question that Texas has regulated health and accident insurance to some extent during the period of time relevant to this suit. However, Petitioners particular challenged activities have not ben regulated, and it is the latter regulation that must be present to invoke immunity. The Act's legislative history demonstrates that mere general regulation of the business of insurance by the States was to be insufficient for immunity.

> Senator Barkley: I should like to ask, in this connection, whether, where States attempt to occupy the field — but do it inadequately — by going through the form of legislation so as to deprive the Clayton Act, the Sherman Act, and the other acts of their jurisdiction, it is the Senator's interpretation of the conference report that in a case of that kind, where the legislature fails adequately even to deal with the field it attempts to cover, these acts still would apply?
>
> Senator McCarran: That is my interpretation. 91 CONG. REC. 1444 (1945).



The federal antitrust laws were to remain in effect in a State unless the State enacted "adequate" regulation — regulation of the particular challenged activities.

This test of "adequacy" is carried into the Act by the "to the extent" phrase in the proviso. It requires courts to inquire into the *specific* impact of the State law, not merely to ascertain that some state law concerning the type of insurance involved has been enacted. Congress did not intend that the Act be utilized to institute a system of *private regulation* by insurers with mere tacit approval by the States. Although Congress desired to authorize State supervised rate-seting, it was as opposed to private price-fixing as ever. *See*, in particular, the comments of Senator O'Mahoney, a co-sponsor of the bill, in 91 CONG. REC. 1480, 1483, 1485 and 1486 (1945).

As has been discussed extensively in various contexts throughout the body of this brief, Texas does not regulate Petitioners' challenged activities as a part of the business of insurance. Although Petitioners persistently refer to "aggressive" and "pervasive" regulation of their challenged activities, this Court must not be misled. The entire want of regulation in the area of Petitioners' challenged activities is underscored by the fact that Texas does not even regulate Blue Shield's premium rates to its own subscribers, much less its activities as a private regulator or "container" of prices in the retail pharmaceutical industry. *See* Pogue Depo. at 64. Texas does not regulate the amounts to be paid to providers of benefits under health and accident insurance

policies, which includes Blue Shield's Prescription Drug Insurance Policy. (Pogue Depo. at 59-60). Thus, unlike the situation in *Travelers Ins. Co. v. Blue Cross*, 481 F.2d 80 (3d Cir), *cert. denied*, 414 U.S. 1093 (1973), and *Travelers'* progeny in Pennsylvania, it cannot be argued that Petitioners' challenged activities are being undertaken in response to duress, request, or even simple urging by the Texas Commissioner of Insurance. The Commissioner does not even have authority to regulate Blue Shield's premium rates in Texas, much less urge, tactly approve, or even supervise the entirely private price fixing activities pursued by Blue Shield and the Petitioner pharmacy chains in the retail pharmaceutical industry. Petitioners are acting solely as "volunteers."

Texas' entire want of regulation in the area of Petitioners' challenged activities is further underscored by Petitioners' reference to "special legislation designed to further the states' cost containment objective." Brief for Petitioners at 25. In referring to such legislation, Petitioners fail to cite any authority other than the NAIC Brief. The NAIC Brief cites laws in three States that purportedly "regulate the rate of reimbursement to hospitals." NAIC Brief at 32. What about TEXAS — the state in issue? Where are the TEXAS statutes regulating the rate of reimbursement to *retail pharmacies*? Where are the TEXAS statutes regulating the terms of Blue Shield's contracts with retail pharmacies? There are none! Texas has absolutely no regulation of the business of insurance in the area of Petitioners' challenged activities. Petitioners' challenged activities are entirely unsupervised and unregulated.

Petitioners argue that TEX. INS. CODE ANN. art. 21.21 applies to their challenged activities. Respondents respectfully request that the Court closely scrutinize the provisions of article 21.21. It would certainly be a *tour de force* to find any provisions in article 21.21 that would reach Petitioners' price fixing activities in the retail pharmaceutical industry. As Texas courts have recognzed, articles 21.21 § 4 has as its purpose the prevention of "monopoly or unreasonable restraint in the business of *supplying insurance*." *Russell v. Hartford Casualty Ins. Co.*, 548 S.W.2d 737, 742 (Tex. Civ. App. — Austin 1977, writ ref'd n.r.e.). There is nothing in the statute's language nor in the decisional law interpreting it that remotely suggests the statute would or could reach a conspiracy between an insurer and retail pharmacy chains to fix the retail sales prices of pharmaceuticals. Petitioners' challenged activities constitute a private system of wage and price control in the retail pharmaceutical industry, implemented by entities with overwhelming market power. These activities are being conducted without the safeguards of a state scheme of administrative antitrust laws.



## III.

## THE EXISTENCE OF BOYCOTT, COERCION, AND INTIMIDATION ELIMINATE THE IMMUNIZING EFFECTS OF THE McCARRAN ACT IN THIS CASE.

In granting a summary judgment for Petitioners, the District Court held that the "boycott, coercion, intimidation" exception in Section 3(b) of the McCarran Act is limited to "the issuance of black-lists naming insurance companies or agents." (App. 112a). Since this case does not involve black-listing of insurers or their agents, the exception was held inapplicable. *Id.* The Fifth Circuit did not address applicability of the boycott, coercion, or intimidation exception due to its finding that Petitioners' challenged activities do not constitute the business of insurance.

Petitioners' challenged activities directed against independent pharmacists who refuse to sign The Pharmacy Agreement and fix their prices at the specified level are deprived of possible McCarran Act immunity by section 3(b) of the Act. 15 U.S.C. §1013(b) (1970). Section 3(b) provides that the Sherman Act remains applicable to an insurers' activities if they constitute "any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation."

The District Court's restrictive reading of section 3(b) was recently rejected by the Court in *St. Paul Fire & Marine Ins. Co. v. Barry*, ..... U.S. ..... (June 29, 1978). The reasoning utilized by the Court in holding that the "boycott" exception applies to disputes between policyholders and insurers applies with especial force to disputes between insurers, their provider industry co-conspirators, and providers of goods and services contemplated by the insurance policy. It is not conceivable that the exception protects insurance companies and policyholders from anticompetitive practices, but withholds similar protection from providers of policy benefits who are victimized by private, predatory agreements. Providers are removed from the insurer-policyholder relationship, which the Court recognized as the focus of the Act in *S.E.C. v. National Securities, Inc.*, 393 U.S. 453 (1969).

As has been discussed extensively, Petitioners have conspired to effect a boycott by Blue Shield's subscribers of those independent pharmacists who refuse to fix their retail sales prices at the specified level. The subscriber receives markedly reduced financial benefits and must undergo an administrative burden if he patronizes a pharmacy that has refused to agree on retail sales prices. It is a rare subscriber indeed who is willing to shoulder the extra burdens placed



in his path by Blue Shield in order to patronize the pharmacy of his choice. The success of the boycott is documented in the record. Of the 31,000 claims per month processed by Blue Shield in late 1975, over 98% were for purchases at "participating pharmacies." (Helis Depo. at 10, 13) (App. 281a-282a).

Petitioners coerce and intimidate independent pharmacists to fix their prices at the specified level by withholding from them the patronage of Blue Shield's many subscribers. These activities constitute a form of private economic regulation in the marketplace that, by virtue of the boycott exception, remains subject to scrutiny under the Sherman Act. As the Court observed on pages 14-15 of its *Barry* opinion:

> The debates make clear that the 'boycott' exception was viewed by the Act's proponents as an important safeguard against the danger that insurance companies might take advantage of purely permissive state legislation to establish monopolies and enter into restrictive agreements falling outside the realm of state-supervised cooperative action.

The absence of state-supervision with respect to Petitioners' challenged activities is patent. Petitioners have gone beyond merely taking advantage of permissive State legislation. They have conspired to impose their own brand of private market regulation.

The vice of private government by insurance companies clearly exists in this case. Petitioners' activities unnecessarily penalize pharmacies who refuse to agree on retail prices and thereby stifle competition and the free operation of market forces. As the D.C. Circuit has so ably articulated,

> Such collective use of the insurance companies' power to enforce the terms of a horizontal price-fixing agree-

ment, would thus constitute "boycott, coercion, or intimidation" within the meaning of the boycott provision. *Proctor v. State Farm Mut. Auto. Ins. Co.*, 561 F. 2d 262, 275 (D.C. Cir. 1977), *pet. for cert, pending*, No. 77-580.

Petitioners desire to utilize Blue Shield's power to enforce a horizontal price-fixing agreement among pharmacists. Section 3(b) of the McCarran Act dictates that such activities remain subject to Sherman Act scrutiny.

Petitioners claim they are merely trying to "contain" the cost of pharmaceuticals and thereby keep the cost of insurance premiums at a lower level. Although this professed objective many sound laudible, as it was intended to sound, insurers may not seek to achieve such objectives by conspiring to tamper with the economics of the retail pharmaceutical industry by boycott, coercion, or intimidation, 15 U.S.C. §1013(b) (1970). In the language of the Fourth Circuit, Respondents' complaint, "therefore, alleges conduct that falls within §1013(b) of the McCarran-Ferguson Act subjecting insurance companies, and those who have conspired with them, to the antitrust laws." *Ballard v. Blue Shield of Southern West Virginia, Inc.*, 543 F.2d 1975, 1978 (4th Cir. 1976).

Certainly, if boycotts of insureds are without the McCarran Act as *Barry* held, boycotts, coercion, and intimidation of independent pharmacies by insurance companies and competing pharmacists are even further removed from the Act's immunity and create a clear case justifying application of Section 3(b) of the Act. Indeed, as the court stated at page 20 of *Barry* case:

> "This concerted refusal to deal went well beyond the private agreement to fix rates in terms of coverage, as



> it denied policyholders the benefits of competition in vital matters such as claims policy and *quality of service.*"

Further, as the record demonstrates despite the numerous erroneous statements by Petitioners and their amici, there is no State authorization of the conduct in question.[15] Section 3(b), by its express terms, subjects Petitioners challenged activities to Sherman Act scrutiny.

## IV.

**SINCE THEY CLEARLY ARE NOT INSURANCE COMPANIES, AND ARE NOT PERFORMING ACTIVITIES CUSTOMARILY UNDERTAKEN BY INSURERS IN THE SALE OR FINANCING OF INSURANCE POLICIES, THE PETITIONER PHARMACY CHAINS CANNOT RELY ON THE McCARRAN ACT TO INSULATE THEIR ACTIVITIES FROM FEDERAL ANTITRUST SCRUTINY.**

There can be no doubt that in enacting the McCarran Act, Congress' sole concern and purpose was to exempt *insurance companies*, their agents, and employees from federal regulation with respect to their activities constituting the business of insurance, when such activities are adequately regulated by State law. Congress never contemplated nor intended that the McCarran Act be utilized to insulate from the federal antitrust laws other entities that might deal with insurers in some capacity. The Supreme Court has recognized that Congress intended the Act to be utilized to exempt insurance companies from federal scrutiny with respect to their activities constituting the business of insurance by observing as follows:

> "The McCarran-Ferguson Act was an attempt to turn back the clock, to assure that the *activities of insurance*

[15] Certainly, not *all* actions which could conceivably be authorized by state insurance regulation would necessarily be part of the "business of insurance."

> *companies* in dealing with their policyholders would remain subject to state regulation." *S.E.C. v. National Securities, Inc.*, 393 U. S. 453, 459 (1969) [emphasis added]

*Accord, e.g., Meicler v. Aetna Cas. and Surety Co.*, 506 F.2d 732, 733 (5th Cir. 1975). In drafting the Act, "Congress was mainly concerned with the relationship between insurance ratemaking and the antitrust laws, and with the power of the States to tax *insurance companies*." *S.E.C. v. National Securities, Inc.*, 393 U.S. 453, 458-59 (1969) [emphasis added].

The utilization of the McCarran Act to immunize entities other than insurance companies from the antitrust laws would in no way further the purposes behind the Act. Such application would not assure "that the activities of insurance companies in dealing with their policyholders would remain subject to state regulation." It would not in any way be guaranteeing that State regulation and taxation of insurance companies remain free from federal interference.

The Court has emphasized that the Act is aimed at insurance companies, as contrasted with other entities, which by definition cannot engage in the business of insurance, by observing as follows:

> "*Insurance companies* may do many things which are subject to paramount federal regulation; only when *they* are engaged in the "business of insurance" does the statute apply." 393 U. S. at 459-60 [emphasis added].

Other Courts have joined in this interpretation. *See Pastor v. Hartford Fire Ins. Co.*, 5 CCH Trade Reg. §60,783, at 68,396 (C.D. Calif. March 5, 1976) (holding that the Los Angeles County Medical Association, in allegedly conspiring with insurance companies, was not engaged in the business of insurance and could not rely on the McCarran Act to immunize its conduct); *Center Ins. Agency, Inc. v. Byers*, 5 CCH Trade Reg. §60,940, at 69,122 (N.D. Ill. June 10, 1976) (holding that non-insurance companies cannot be engaged in the business of insurance).



Petitioners argue that by contracting with Blue Shield to provide benefits, the pharmacy chains are engaging in the business of insurance. There are definite conceptual problems with this theory. Its acceptance leads to the conclusion that a pharmaceutical distributor is engaged in the "practice of medicine" if it sells antibiotics to a physician for administration by the physician in his office. After all, the physician is obviously engaged in the practice of medicine when he administers an injectable antibiotic. Utilizing Petitioners' reasoning, we must conclude that the pharmaceutical distributor has become an "integral part" of the physicians' practice of medicine since it has "contractually agreed with" the physician to provide the substance that he has agreed to administer to his patient. The unacceptability of this reasoning is no less in the context of a pharmacy's being engaged in the "business of insurance".

Although the Seventh Circuit in *Lowe v. Aarco-American Inc.*, 536 F.2d. 1160 (7th Cir. 1976), did cloak two non-insurance company defendants with McCarran Act immunity concerning alleged violations of the Truth in Lending Act, the holding of that case is much narrower than Defendants imply. The defendants were an insurance broker and a premium finance company. They were sued for alleged violations of the Truth in Lending Act that allegedly occurred in their credit sales of insurance policies. The Seventh Circuit correctly held that the credit sales of insurance

policies are part of the business of insurance and correctly invoked McCarran Act immunity. Although the two defendants in *Lowe* were not insurance companies, they were performing activities customarily performed by insurers. One defendant sold automobile insurance policies and the other defendant financed the premiums required under those policies. In this regard they could be viewed as extensions of the insurance company. The Seventh Circuit expressly noted that Illinois regulates premium finance companies under the Illinois Insurance Code.

The Petitioner pharmacy chains herein, unlike the defendants in *Lowe*, are not performing activities customarily performed by insurers. Neither the sale of pharmaceuticals nor the fixing of prices in the pharmaceutical industry are customary activities of insurance companies, and the Petitioner pharmacy chains cannot by virtue of their price fixing activities be considered extensions of an insurance company. *Lowe* serves as no precedent for the extension of the McCarran Act to the activities of the Petitioner pharmacy chains in conspiring and agreeing to fix prices.

The liberal interpretation that the Petitioners place on the exemption afforded by the McCarran Act conflicts with the Court's admonition that "there is a heavy presumption against implicit ]antitrust[ exemptions." *Abbott Lab. v. Portland Retail Druggists Ass'n, Inc.*, 425 U.S. 1, 12 (1976), *quoting Goldfarb v. Virginia State Bar*, 421 U.S. 773, 787 (1975). Since the McCarran Act operates in derogation of the federal antitrust laws, it is to be strictly construed. *American General Ins. Co. v. F.T.C.*, 359 F. Supp. 887, 894 (S.D. Tex. 1973), *aff'd*, 496 F.2d. 197 (5th Cir. 1974). There is absolutely no indication that either Congress in drafting the McCarran Act, nor the Court in interpreting it, entertained the idea that the Act would or could apply



to entities other than insurance companies and their agents or employees. In th absence of such an indication, utilization of the McCarran Act to insulate the Petitioner pharmacy chains' conduct from antitrust scrutiny constitutes an unwarranted expansion of the act at the expense of the federal antitrust laws.

If the Petitioner pharmacy chains' activities are subjected to scrutiny under the antitrust laws, the thrust of the McCarran Act would in no way be violated. It could not be argued that such action would serve to "invalidate, impair or supersede any law enacted by . . . [the State of Texas] for the purpose of regulating the business of insurance." *See* 15 U.S.C. §1012(b) (1970). The uncontradicted evidence demonstrates that the Texas State Department of Insurance has no jurisdiction or regulatory authority over pharmacies (Pogue Depo. at 53, App. 339a) even though the Texas legislature has given the Department "regulatory authority over anything that encompasses insurance in the State of Texas." (Pogue Depo. at 66, App. 345a). Application of the antitrust laws to Petitioner pharmacy chains, then, would not interfere with the administration of any Texas statute regulating the business of insurance.

Even if Blue Shield were able to immunize itself from the federal antitrust laws with respect to the activities challenged herein through reliance on the McCarran Act, the Petitioner pharmacy chains could be held accountable under the antitrust laws for their activities in combining and conspiring with Blue Shield and each other. The McCarran Act, where applicable, merely immunizes an insurance company from the regulatory control of federal statues for its conduct constituting the business of insurance; it removes federal jurisdiction over the insurer with respect to

such activity. The McCarran Act does not, however, in any way declare the insurer's activity to be legal or to be in compliance with the federal antitrust laws.

Inability to maintain an antitrust suit against an insurance company for its activities consitituting the business of insurance, due to the insurer's jurisdictional immunity for such activities, does not prevent maintenance of an antitrust action against a non insurance company co-conspirator who does not, by definition, fall within the ambit of the McCarran Act. The situation is analogous to that involving an illegal combination or conspiracy between a domestic and a foreign corporation.

The Supreme Court has long recognized that inability to obtain jurisdiction over, or enforce a judgment against one party to an illegal combination or conspiracy does not free the other party from application of the federal antitrust laws. *See e.g., Timken Roller Bearing Company v. United States*, 341 U.S. 593 (1951) (upholding jurisdiction in a civil antitrust action charging Timken Roller Bearing Co., an Ohio corporation, with violations of the Sherman Act in combining and conspiring with British Timken, Ltd. and with Societe Anonyme Francioise Timken to restrain interstate and foreign commerce). The situation is also analogous to that involving a domestic corporation that has acted as the agent of a foreign nation that is not within the jurisdiction of the United States district courts due to sovereign immunity. The Supreme Court has held that immunity cannot be claimed by or on behalf of a domestic corporation merely because it was acting as the instrumentality or agent of a government that is itself immune from suit. *See e.g., Sloan Shipyards Corp. v. United States Shipping Board Emergency Fleet Corp.*, 258 U.S. 549, 567



(1939). Petitioners Rieger, Sommers, and Walgreens are likewise precluded from relying on any McCarran Act immunity that Blue Shield might have to escape application of the federal antitrust laws.

There is an additional and controlling reason why the Fifth Circuit's decision must be affirmed as to Rieger, Sommers and Walgreens. Their activities as challenged herein are not confined to acts of combination and conspiracy with Blue Shield. The Petitioner pharmacy chains have also combined and conspired with each other to fix the retail sales prices for pharmaceuticals and to foreclose Respondents from a substantial portion of the market for prescription pharmaceuticals. The McCarran Act can have no possible applicability to such acts.

## CONCLUSION

A central purpose of the antitrust laws is the promotion and preservation of marketplaces in which consumers are provided choices or options in terms of the prices, quality and services associated with the products they purchase. Petitioners' challenged conduct strikes at the very basis of the federal antitrust laws and at the heart of the small businessman.

It is crucial that this Court refuse to expand the McCarran Act exemption so as to give insurers blanket antitrust immunity for all their activities in combining and conspiring with those persons or entities selling the goods and services purchased with proceeds of insurance. The threat to our free market economy that such blanket exemption would present is staggering and is best described

by the Court's own recent language in a non-insurance context:

> "[T]hese bodies . . . [insurers] are fully capable of aggrandizing other economic units with which they interrelate, with the potential of serious distortion of the rational and efficient allocation of resources, and the efficiency of free markets which the regime of competition in the antitrust laws is thought to engender. If . . . [insurance companies and the large providers of policy benefits acting in concert] were free to make economic choices counseled solely by their own parochial interests and without regard to their anticompetitive effects, a serious chink in the armor of antitrust protection would be introduced at odds with the comprehensive national policy Congress established." *City of Lafayette v. Louisiana Power & Light Co.*, ——— U.S. ———, 98 S. Ct. 1123, 1134 (1976).

This Court must not allow the wholesale abandonment of the federal antitrust laws urged by Petitioners. The decision by the United States Court of Appeals for the Fifth Circuit should be affirmed and this cause should be remanded for a trial on the merits.

Respectfully submitted,

JOEL H. PULLEN
STEPHEN F. LAZOR

By: JOEL H. PULLEN

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# APPENDIX A

May 28, 1968

Mr. Tom L. Beauchamp, Jr., President
Group Life & Health Insurance Co.
Main at North Central Expressway
Dallas, Texas 75222

Re: Drug Program — Indemnity Areas

Dear Tom:

For areas like yours who are faced with the auto "service" drug program, I have a germ of an idea (which you may have already discarded) hinged mainly on providing a greater indemnity to pharmacies (acquisition cost plus dispensing fee) because of agreement to use a "bulk or simplified" accounting base; i.e., more benefit because of lesser administrative cost. The mass accounting agreement would then serve like a participating agreement.

1. On the subscriber contract the indemnity would be 75% of usual and customary, subject to the provision that Blue Shield, under a facility of payment clause, shall extend indemnity, to the extent that a subscriber need pay no more than the deductible for such item, for drugs billed for by and payable to all pharmacies agreeing to Blue Shield's mass claims accounting agreement, as may be established by Blue Shield.

   The basic claims payment clause would be to pay the subscriber or, by using a facility of payment clause, the pharmacy. The company's option to use the facility of payment clause would uniformly be for those pharmacies having a mass accounting agreement. I think it would be best to draft the contract so that the Insurance Board would require filing of the mass accounting agreement to strengthen your base on anti-trust. Drafting problems will get sticky here, but let's pass on that for now.

2. The mass accounting agreement probably should have self-service whereas clauses emphasizing Blue Shield's intent to offer coverage, desire to relate payments to

providers for these services, and the need to simplify administration and accounting in the public interest. The basic agreement would be that the accounting basis of indemnification under the facility of payment clause of the subscriber contract, for Blue Shield subscribers for service rendered by the pharmacy, would be acquisition cost plus dispensing fee in the aggregate for all services within a reporting period and that the pharmacy would make no charge to the subscriber in excess of the deductible. The pharmacy's quid pro quo is "averaging", bulk submissions and payment to him.

Tom, there are a lot of holes in this, but the alternative is paying usual and customary — and praying.

Sincerely,

Marv

M. C. Reiter